

Why are Private Pensions Taxed after 75?

What happens to money in a private pension arrangement on a person's death? And why are they taxed after the age of 75? Chris Budd looks at an issue which comes under the heading "boring but important" - and could affect millions of older people.

Many people have elected to roll up their private pension fund into an annuity. Basically the pot of money will provide you with a guaranteed income - which is good. The disadvantage is that the capital is lost on death.

Of course, it is possible to protect the income, by adding widow(er)'s pension and inflation proofing, but this significantly reduces the initial level of income payable.

In this way, annuities represent something of a gamble - if you live to a ripe old age, you may get more than your fair share out of your pension. If you don't - you won't!

However, there is an alternative: leave the pot invested, and draw your income from it. The income is now no longer guaranteed, and is reliant upon investment returns. Nevertheless, it is much more flexible than annuities, and the income can be varied each year.

This has become increasingly popular over recent years. But what happens to the pot in the event of death?

On death before benefits are taken, the situation is simple - all of the fund is paid to the nominated beneficiary, with no inheritance tax.

Once benefits are taken, but before age 75, the pension is now to be known as 'Unsecured Pension' (USP). On death, a surviving spouse can continue to take the same level of income (100% widow(er)s pension), or alternatively the nominated beneficiaries can take the value of the fund, minus 35% tax.

Although some may be dismayed at the introduction of tax at this point, the position is broadly in line with inheritance tax (albeit with no nil rate band), and is certainly considerably better than the annuity.

The real problem comes after age 75. Now, the pension is reclassified as 'Alternatively Secured Pension' (ASP), and the surviving spouse can still continue to receive the income. However, on that person's death, the Inland Revenue has allowed only two options: the whole fund can be left to either the Inland Revenue, or to a registered charity.

There had been a very short period when it was possible to leave it to your children's pension funds, however this has now been reversed. Quite why, nobody knows (although suspicions have been suggested that continuing to force annuity purchase, which is funded by the purchase of gilts, i.e. Government borrowing, has a part to play). Certainly, there is deep disquiet in the industry and amongst the public at this situation.

So, once told that all of their pension pot is going to be given to charity after age 75, how is the public likely to react? Well, a number of our clients have decided to not take annuities, but instead draw the maximum pension possible through "Drawdown", thereby eroding the fund. In this way, they can remove as much money out of the pension before age 75 as possible, and therefore leave as little as possible to their next of kin.

The change in legislation is therefore having exactly the opposite effect that the Government would want. People are drawing much higher levels of income than is sensible, which, in the long run, will lead to reducing income, and potentially greater reliance for the welfare state.

Leaving one's pension fund to one's children's (or grandchildren's) pension fund (probably after inheritance tax has been taken) could solve a number of problems. By setting aside funds for retirement income in this way, we could have an instant impact on dependency on the State in future generations. By abolishing this, the Government may have missed a trick.

Drawdown is only really an option with significant private pension arrangements (perhaps £100,000 or more), and is a highly delicate area, with many important decisions to be made. Careful advice should therefore be sought by anybody considering using private pension funds to draw pension, and in particular if they are considering using the flexibility of Drawdown.

This article is for general information only. Remember past performance is not a guide to future performance and investments can go up as well as down. If you have any doubts in respect of your own personal circumstances you should request a full review with an independent financial adviser to get their help.

Ovation Finance Limited is authorised and regulated by the Financial Services Authority.

This article appeared in the Mature Times September 2007 issue - visit their website at www.maturetimes.co.uk

email: enquiries@ovationfinance.co.uk **www.ovationfinance.co.uk**

Registered address: [Ovation Finance Limited](#) 141 Whiteladies Road, Clifton, Bristol BS8 2QB. VAT no. 742 1527 53

Registered in England and Wales. Company registration number 3830502. [Ovation Finance Limited](#) is authorised and regulated by the Financial Services Authority