

It's been said that there are only two certainties in this world: death and taxes. Yet while death may be inevitable, avoiding its subsequent taxation has resulted in the payment of the lump sum death benefit being a potentially complex process for trustees.

Death benefits for pension scheme members fall into two categories. There are dependents' pensions, generally for spouses/children, offered by DB schemes, and a discretionary lump sum death benefits a one-off payment provided by both DB and DC schemes.

Dependents' pensions are the more 'straightforward' of the two, as it is mandatory and subject to strict instructions as to who can receive the pension written in the scheme rules.

### The discretionary challenge

In contrast, the lump sum death benefit can pose a challenge to trustees due to its discretionary nature.

The lump sum has to be discretionary as, according to HMRC's Inheritance Tax Manual, "where pension scheme providers have discretion over the payment of death benefits (whether or not any letter of wishes is followed) the payment is not treated as part of the estate", so therefore not subject to inheritance tax.

The member can fill in an expression of wish form, nominating who they would like to receive the benefit, but the trustees must demonstrate that they are exercising their discretion and not just following the form when paying out the benefit.

In the majority of cases this decision can be quite simple, with the decision as to who should receive the benefit obvious and matching the nomination form.

But as Speechly Bircham partner and head of pensions Penny Cogher says, the nomination form is not binding, but "it takes quite a brave trustee to go against the form's wishes

### Summary

- Death benefits fall into two categories, dependents pensions and a discretionary lump sum.
- Trustees have to undertake research for potential beneficiaries and take into account all relevant factors when paying the discretionary lump sum.
- Members should be encouraged to keep up to date nomination forms.
- The move to DC and the Budget announcements may increase engagement with what happens to a member's benefits after death, as the pension pot may seem more 'tangible'.

# A deadly choice

✓ **Laura Blows explores the challenge trustees face when determining who should receive death benefits following the demise of a pension scheme member**

unless there is a good reason to do so?

However, when these 'good reasons' occur it can prove a time-consuming and draining process for all concerned.

Some of the common complications that can arise include the member's out of date expression of wish form nominating their spouse although they have since divorced or are in the process of divorcing, previously unbeknown children coming out of the woodwork, or dependent children from numerous marriages creating difficulties for trustees as to how to divide the benefit.

"The trustees don't like it if they feel the member's personal circumstances are quite difficult with no clear right answer

where the money should go, and the nomination form is not up to date," Cogher says.

The trustees' personal knowledge of the deceased member's circumstances can be beneficial in determining how much weight to put on the nomination form, although any conflicts of interest that the trustees may have must be declared.

The trustees should also speak

## LAST WILL AND TESTAMENT

OF: \_\_\_\_\_  
(Insert your name)

DATE: \_\_\_\_\_

Form Prepared By \_\_\_\_\_

Last revision: Dec. 8, 2004-12-08



to people that knew the member and make enquiries into possible dependents.

“You have to decide how much research is appropriate, what would be deemed appropriate if the case was put before the ombudsman,” Dalriada Trustees director Adrian Kennet says.

Once this information has been gathered, trustees have to determine the relevant and irrelevant factors.

Taylor Wessing partner Rosalind Conner gives the example where the deceased member had requested in the nomination form that the lump sum went to her partner. Her two adult children wrote to the trustees stating that the partner was abusive to their mother and them as children, and that he was an alcoholic.

“The first point isn’t actually relevant, as any old evil person can win the lottery,” she explains, “but the second can be considered relevant as the money may be squandered due to his addiction problem.” Research would have to be undertaken to prove his alcoholism instead of relying only on the daughters’ concerns, Connor adds.

### Following a process

In determining who should receive the benefit, it is important that trustees establish and follow a consistent process.

“If trustees make ad hoc, inconsistent decisions in what people perceive to be similar circumstances, if they do not follow the established process, and if they do not explain their reasoning to the individuals concerned then they are asking for trouble,” Kennet explains.

As part of this process, trustees also need to be aware of the risk of holding data. Premier senior consultant John Reeve notes that as a response to data concerns, most trustees hold expression of wish forms in sealed envelopes, with any previous versions destroyed.

“However, we have had cases where, when the envelope was opened, it was found to contain general correspondence rather than the expression of wish form,” he warns.

According to Reeve, trustees need to consider how to keep hold of these forms. Electronic scanning and scanning may be one option, but “questions of confidentiality need to be carefully considered”.

Trustees are allowed to keep the data as long as they use it for its specific reason, Cogher says, but once it has been used for that purpose it should be destroyed. The holding of data has yet to cause problems, she adds, as members recognise that they need to give the data in order to receive the benefit.

Determining who should receive the lump sum can take a long time to decide. However, it should

### ❏ Complicated cases

While the vast majority of death benefit payouts are straightforward, trustees sometimes have to face very complex and unusual situations.

Even seemingly simple cases can become complex. DLA Piper partner in the employment group, Matthew Swynnerton, notes one scenario where it seemed obvious to pay the lump sum to the deceased’s mother. “However the mother was relatively old and did not want the money. The trustees were concerned that if they did not pay the money to the mother she may later on complain so they got her to put her refusal in writing,” he says.

While the scheme rules must be abided, it is possible to find solutions to problems created by their prescriptiveness. Speechly Bircham partner and head of pensions Penny Cogher recalls a case where the mother was thought to have committed suicide. The husband had been bullying her and the adult son. The deceased’s parents were still alive, and the son had a girlfriend but was not married or living with his partner.

“The son wanted the lump sum to go to his girlfriend but she did not fall under the category as to whom the money could be paid. So the trustees agreed to pay the money to the grandparents, who said they would pass it onto the girlfriend,” Cogher says.

Premier senior consultant John Reeve had a case where the trustees were faced with a nomination form completed on the day before death, literally from the death bed. “This was presented to the trustees after the death by the new beneficiary who had been named in place of the member’s longstanding, dependent wife,” Reeve says. “The trustees found for the wife on the basis of the dependency although going against the member’s wishes was a difficult decision.”

DWF partner and head of pensions Martin Jenkins says his law firm has advised on death benefits cases that included suicide (with an attempt to amend the nomination form set out in the suicide note) and manslaughter.

The most notable for Jenkins though was a case where four individuals all claimed to be the deceased’s spouse.

He explains that a dependents pension was defined by the rules as any party with whom the deceased had a contracted marriage ‘in a form valid in the jurisdiction where it took place’.

“In that case a trainee solicitor was despatched to the Nigerian High Commission to check on valid marriage ceremonies applicable. Three of the four relationships were found to amount to marriage for the purposes set out – one partner lost out.”

be determined within two years; otherwise it would be classed as an 'unauthorised payment' and become subject to 55 per cent tax.

Even though two years sound like ample time, Connor notes that one dispute she dealt with "took so long to argue over that one of the two potential beneficiaries died".

To speed up the process, it is recommended that trustees set up sub-committees to deal with these payouts.

If by the end of this complaints are made, they tend to be about trustees not taking all considerations into account, or blindly following the expression of wish form instead of first researching all options.

#### **Mandatory or discretionary?**

To avoid this time and complexity, Connor recommends that the tax treatment for the lump sum be changed.

"No one really likes (the discretionary element of the lump sum payment) as trustees have to spend ages looking into the members situation, even though they often follow the member's request, and the member doesn't get that certainty," Connor explains.

Her solution would be to change the current rules so trustees can automatically pay the lump sum to whom the member nominated or their next of kin without it being subject to inheritance tax.

"By far the easiest thing to do is to say that we don't need this benefit to be a discretion, we just need it to get the tax breaks as if it was one, and then the member can direct who can get the money and that would just make everyone's lives massively easier," she adds.

While removing the discretionary element of the lump sum will solve a number of challenges for trustees, it can be a blessing and a curse.

#### **Reducing death benefits costs – case study**

In the UK, QVC operates a television shopping channel, online shopping services and two outlet stores, employing nearly 2,000 people. It has a DC scheme with over 600 active members.

QVC decided to convert the current dependent's death in service pension into an additional lump sum in order to maximise the tax efficiency of the benefit and better control costs.

It was determined that the current death in service pension of one third salary would be removed and replaced with an additional lump sum of eight times salary.

Towers Watson negotiated the insurance contract that resulted in an overall premium cost saving of approximately 5 per cent, with additional cost control in the future due to the removal of the impact of increased longevity on the cost of the benefit.

The dependents' pension element is not discretionary, and as Kennet explains: "If the rules require you to pay it to the spouse, even though the member was separated, then you pay it to the spouse. It may not be what the member wanted but the trustees are constrained by the rules."

This constraint can cause problems for unmarried couples in public sector schemes TPAS chief executive Michelle Cracknell adds.

"We occasionally see some unfortunate cases where a scheme member has died and their partner has been denied a dependents' pension," she explains. "This is because a signed nomination form needs to be held on file if a dependents' pension is to be paid. In the last case I had the scheme (civil service) hold a form for the lump sum benefit but not for a dependents' pension. The

#### **Ombudsman determinations**

As of 22 May 2014, the pensions ombudsman had delivered seven determinations regarding death benefits for the year, of which three were upheld, three were not and one was upheld in part.

Two of the complaints brought to the ombudsman regarded pension schemes trying to recover lump sum payments, two were to do with non-married partners being denied benefits, one dealt with the complainant wanting a larger lump sum payment, another concerned maladministration and one discussed whether a child's pension was to be continued due to ill health.

The complaints against the schemes trying to recover payments, along with the determination concerning maladministration, were upheld or upheld in part. This highlights the importance of schemes carefully checking their death benefits administration and ensuring they have clear processes to follow, in order to avoid costly and irrecoverable mistakes.

Both of the complaints regarding non-married partners failing to obtain a payment were dismissed as the schemes had abided by the scheme rules. These emphasise a lack of understanding by members (and partners) regarding trustees being bound by scheme rules and stress the importance of up-to-date nomination forms.

couple had clearly been in a relationship for a long time but the scheme had no discretion to pay anything."

Cogher states that the discretionary element of the lump sum can have a beneficial role for the member, as whom they nominate to receive the benefit can differ from

their estate.

“People could do something that the family member may not hear much about, so if they wanted to keep something secret this might be a way of doing it. They could make the trustees’ life easier by adding a letter explaining this with their nomination form,” she explains.

### Nomination forms

So both discretionary and mandatory benefits have pros and cons. What would help immeasurably however, for both dependents’ pensions and the lump sum, is an up-to-date nomination form.

Some schemes AHC technical consultant Karen Partridge has worked with only had nomination forms for 10 per cent of its members, “so there is clearly a desire to increase that to make trustees’ job less difficult”.

Including a nomination form within all communications and providing an incentive to return it can help a great deal, she adds. Some schemes also send reminders whenever it becomes aware of a change in circumstance, such as a change of address.

According to Partridge, it is quite a complicated process to explain to members the trustees’ discretion for tax purposes, but that members “should fill in the form even though it may not be abided by”.

### Move to DC

Even though the message is complex, members may be more willing to listen as DC savings increase.

Punter Southall Independent Trustees principal Gillian Graham notes that as more people save in DC schemes, dependents’ pensions are being replaced with lump sums that have a higher multiple of salary insured.

These higher lump sums, along with the Budget announcements

### Dependents’ pensions and regulatory changes

Dependents’ pensions are usually straightforward. Yet regulatory decisions can require the rules to be updated. For instance, the introduction of civil partnerships in 2005, and same sex marriages this year, required schemes to provide benefits to same sex partners that is broadly the same as for an opposite sex couple.

Despite this requirement, civil partnerships and same sex married partners’ dependents’ pensions can be restricted in relation to non-contracted out rights to service that is accrued after 5 December 2005, when the Civil Partnership Act came into effect.

The reason for this, DLA Piper partner in the employment group, Matthew Swynnerton, explains is that if the right was broadened to include all service it could have funding implications for the scheme.

“But schemes could provide more generous benefits,” Swynnerton adds, “so what we found was when schemes looked into this, about half chose to provide the minimum and the other half chose to treat same sex partners the same as opposite ones.”

For schemes only wanting to provide the minimum, there is an urgency to update their scheme rules, as there are some discrepancies in the way the Marriage (Same Sex) Couples Act interacts with the Equality Act, making it not entirely clear as to what happens if scheme rules are not amended, Swynnerton warns.

Another scenario where regulatory decisions can cause problems is when a child is conceived after the pension scheme member has died.

The 1990 Human Fertilisation and Embryonic Act stated that people could not be considered parents to children conceived after their death, although this was amended in 2008 to allow the deceased to be named on a birth certificate.

The terminally ill person freezes sperm or eggs in the full knowledge that they will be used after their death for their partner to have a child. “To all extents and purposes we would regard that child as having those two parents,” Taylor Wessing partner Rosalind Conner says, “but the deceased is only the parent for the purpose of the birth certificate, no other legal purpose.” This means that the child of the deceased would not be entitled to a children’s pension.

“The situation is very quirky,” she adds, “but it did occur to some trustees of mine and they were very upset and uncomfortable at not being able to reward a pension, as the child cannot even fall under the category of dependent, as that is determined as dependent upon the date of the member’s death.”

enabling people to take their pension pot as a lump sum, could make members more likely to keep their nomination form current.

“These changes are making pension money more ‘real’ for the member, so I wonder if this will result in people becoming more diligent about making their wishes heard?”, Partridge muses.

Members may well take more of an interest in their death benefits as their pension pots become more tangible. Only time will tell. But until then, along with death and taxes, death benefits creating challenges for trustees seem another certainty.

Written by Laura Blows