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Pension Fund Tax Note

1 message

gavin mccloskey <gavinm@retirement.capital> 5 August 2024 at 19:56
To: Sue Bradbury <sbradbury@trevellyan.co.uk>
Cc: Emily McAlister <emily@retirement.capital>

Dear Lance,

Further to our previous call I set out below the wider tax considerations in respect of the fund and options available.

Pension Fund Structure

Currently, two members—yourself and Alex—have been allocated funds within the pension scheme. According to the 2023 accounts, the total value of the pension fund stands at £6.257 million, not including the revaluation of company shares, which would increase this amount.

The pension fund operates as a discretionary trust, granting you the flexibility to allocate funds in a tax-efficient manner.

Allocation of the Fund as UK tax residents

- **Alex's Allocation**: The maximum lump sum benefit payable to Alex is £268,275, utilising £1,073,100 of the fund.
- **Your Allocation**: You are entitled to a maximum lump sum of £450,000, which would use £1,800,000 of the fund.

This allocation leaves a remaining balance of £3.384 million in the fund for consideration. Please note, no further tax-free payments can be made to either of you, regardless of additional pension contributions being paid.

Future Funding

Contributions made by the company qualify for corporation tax relief at the current rate of 25%. Once contributions are paid, any profits generated by the pension fund—including capital gains and investment income—are exempt from taxation.

However, any withdrawals from these contributions will be taxed at your highest marginal rate, which can reach up to 45% on income exceeding £125,140 within a tax year. Given this structure, it is advisable to re-evaluate the future contributions to the pension fund.

It should also be noted that once you take income from the pension fund the annual allowance reduces from £60,000 p.a. to £10,000 p.a. under current tax rules.

The Excess Fund

The remaining excess fund of £3.384 million requires further analysis. You have two additional members, Matthew and Lewis. Currently, we do not hold the final deed of appointment for them as trustees . If you do not have that document we will get this in place.

Options for Excess Fund Allocation

Option 1: Allocate Funds to Matthew and Lewis

- The earliest age for Matthew and Lewis to draw income is 55. The maximum tax-free lump sum is £268,275, utilising £1,073,100 from the fund. After their allocation, £1,237,700 will remain in the fund (the original £3.384 million less two allocations of £1,073,100).
- The remaining £1,237,700 can then be allocated to you and Alex. You both can withdraw any amount from this sum, but you will be subject to income tax at your marginal rate on the payments.

Option 2: Allocate Excess funds only to You and Alex

- In this scenario, Matthew and Lewis would not receive any allocations and would only inherit funds upon your passing. This means the entire excess fund of £3.384 million would go to you and Alex immediately. Consequently, you would pay income tax at your marginal rate (up to 45%) on the amounts drawn over your lifetimes under UK residency rules.

Conclusion: Option 1 is the most tax-efficient route available for UK taxpayers at this time. This is because both Matthew and Lewis will each have a tax free lump sum under option 1, but they will lose this option under Option 2 since the money will become part of your estate for IHT purposes.

Tax Residency Implications

As a Jersey resident but UK tax registered person, you will pay 45% tax on pension income exceeding the threshold of £125,140. In Jersey, the taxation structure consists of 20% on worldwide income up to £1,250,000, with 1% applied to income above that amount based on the information I have seen. There may be special concessions which your local tax advisors can advise you further on.

There are jurisdictions where no income tax applies to pension income. I can provide guidance on these options. Additionally, I would also recommend that you reassess your UK ties in relation to tax assessments on income; establishing Jersey as your tax residence could also make it beneficial for pension contributions originating from your UK business. Also, your income tax would be substantially lower in Jersey.

Distribution of Funds Upon Death

Currently under UK tax residency rules on death any funds allocated to you or Alex are payable without incurring inheritance tax or income tax, irrespective of whether you have withdrawn your tax-free lump sums. However, this situation changes post- age 75.

Funds that were allocated upon your death will be distributed to Alex or your sons, with the income taxed at their respective marginal rates. Funds can also be transferred to grandchildren or charities as designated by you. For this purpose, I recommend updating your nomination of beneficiaries on your wishes.

Excess funds remaining in the scheme that have not been allocated or drawn as income can remain in the pension fund as a legacy trust or be allocated to any beneficiaries at your discretion, with the tax assessment applying to the individual rather than the fund when the money is paid out.

Next Steps

We need to update the pension scheme documentation in line with our tax planning efforts. Thankfully, many documents can now be signed electronically. To facilitate this process, please provide the email addresses for Alex and your sons, so we can ensure the scheme rules and trust documentation are current and accurate.

In light of the substantial tax considerations associated with pension income within the current UK tax framework, I suggest we arrange a further telephone conversation to crystalise on how you wish to move forward. Kind regards

Gavin

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