PK Employee Benefits - What happens to my pension when I die?

There are two main types of pension:

- **Defined Contribution** – where you have an invested pot of money.
- **Defined Benefit –** where you receive a guaranteed level of income for life in retirement.

Generally speaking, for Defined Contribution pensions, the death benefit is a simple return of the fund value at the date of death to your beneficiaries.

And, for Defined Benefit schemes, the death benefit is usually a percentage of the member's pension being paid to a spouse/partner and/or dependent children.

However, it's not always that simple and so we've put together this guide to help you with some of the detail.

Defined Contribution

We will focus here on modern pensions where the death benefits situation is fairly straightforward and usually a simple payment of the fund value at the date of death.

Those with pensions taken out in the 1980s, 1990s and early 2000s should look closely at their policy or scheme documents as there may be some more complicated options including, but not limited, to:

- Death benefits being less than the fund value (for example, where the policy only gives a 'return of premiums paid' in the event of death).
- Death benefits being greater than the fund value (for example 'with profits' investments may pay out terminal or final bonuses on death).
- Life insurance included within the pension.

Modern pensions, including workplace pensions, will almost always pay a lump sum on death equivalent to the fund value at the date of death. However, **tax treatment** of this will vary depending upon the age at death of the member:

- Death before age 75: benefits usually paid tax-free.
  If the pension provider can pay directly to beneficiaries then the payment is tax-free. For this reason it's important to make sure you have up to date nominations – this can usually be achieved via your pension provider's online portal.
  Your pension is held under trust and so outside your estate for Inheritance Tax purposes.
  If the pension provider cannot find a suitable beneficiary they may pay the proceeds into your estate and then the proceeds could be subject to Inheritance Tax if the estate is over the relevant threshold at the time.
- Death after age 75: benefits taxed at the beneficiary's marginal rate of Income Tax.
  If your beneficiaries choose to take the money out in stages via Flexible Drawdown then they will only be taxed on any income that they take in the Tax Year that they take it.

Note: Not all pension providers can facilitate Flexible Drawdown for beneficiaries and so a transfer may be necessary to achieve this.

Annuities

If you've bought an annuity with some, or all of your pension pot then death benefits will be determined by the options selected when you selected the annuity.

In broad terms these are:

- Spouse/partner pension – Your spouse can receive a proportion of your pension after your death.
- Guarantee period – your pension will be paid as if you were alive until the end of the guarantee period.
- Value protection – a lump sum may be payable if this income is selected.

As with invested pots, Income Tax is payable on beneficiary income payments on death after age 75 but not on death before this age.

Defined Benefit (sometimes known as 'final salary' or career average') schemes

The pension benefit in these schemes is usually based upon how many years membership the individual has and what their income was whilst a member.

After leaving the scheme, the member normally has entitlement to a 'deferred pension'. This is typically indexed annually to help offset the effects of inflation and will have a 'Normal Retirement Date' (NRD) at which point pension benefits normally start being paid.

Subject to the scheme rules, members can often retire early on a reduced pension, or later on an increased pension.

Death benefits in such schemes may be:

1. **A dependent's pension -** Usually this will be a percentage of the pension the member was receiving, or would have received, if they die before retirement.
   This will usually be limited to spouses/civil partners and dependent children (subject to an age cap, often age 23, and/or provided they are in full time education).
   Some schemes will pay benefits to unmarried partners but may require proof of financial dependency or co-dependency.
   Dependent's pension income is taxed as earnings at the individual's marginal rate.

2. **A lump sum -** Some schemes will also pay out a lump sum on death. This may vary significantly depending upon whether the member was still an active member or a deferred member.
   Lump sums are usually paid tax-free to the beneficiary if the member dies before age 75.

Please Note: This is an overview of the main types of pension and the most common death benefits and is intended for information purposes only and not intended to provide advice.

Some schemes, especially Defined Benefit schemes or older Defined Contribution schemes, may have other options and so it is important that every individual checks the specific death benefits for any scheme of which they are a member.

If your scheme is administered by PK Employee Benefits, the death benefit will be confirmed on your scheme factsheet which is available on request from PK.

Levels and bases of taxation will vary dependent upon individual circumstances and are subject to changeup recommend that employers and individuals take specific guidance before taking any action.