

Adviser guide

Nucleus Discretionary Bypass Trust for use with the Nucleus Pension account

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Important note:

The bypass trust should only be used with the Nucleus Pension account. The scheme administrator has a discretion to pay lump sum death benefits to any person in the discretionary class and the discretionary class includes the trustees of a discretionary trust for the benefit of the member's relatives.

All references to a spouse, widow and widower in this guide should be taken to also refer to a registered civil partner.

In this document all references to a member refer to the Nucleus Pension account holder.

The Nucleus Discretionary Bypass Trust Deed is provided on the strict understanding that it is presented as a draft to be considered by the settlor and their legal advisers. Ultimately, its legal and tax effects will depend on the circumstances of each particular case. Accordingly, neither Nucleus nor any associated or affiliated company nor any of their representatives, officials, employees or professional advisers can accept any responsibility for any loss occasioned as a result of its use in any circumstances whatsoever.

The information contained in this guide is based on Nucleus' understanding of taxation legislation and HMRC's current practices, which may change with or without notice.

1. Introduction – personal pension plans and inheritance tax

Where a person is a member of a registered pension scheme, such as the Nucleus Pension account, substantial lump sums can become payable on their death. Whilst recipient beneficiary(ies) maybe grateful for this money, unless the beneficiary has a plan to spend it, it could accumulate in the beneficiary's estate and be subject to inheritance tax on the beneficiary's death, depending on the circumstances at the time.

If a pension account member establishes a bypass trust during their lifetime and lump sum death benefits are paid to the trust, rather than to a beneficiary, it may be possible to mitigate future potential IHT tax liability on the lump sum without necessarily denying the member's surviving spouse access to the trust assets.

Please note: There will be changes to how unused pension funds will be taxed following a member's (or subsequent beneficiary's) death from April 2027. Following the changes these unused funds will be part of the deceased's estate for IHT purposes in most cases. Please ensure your clients seek the appropriate tax, legal and financial advice so they understand how these changes could affect them and the implications of establishing a discretionary bypass trust and having death benefits paid to this when death occurs.

2. Payment of death benefits – the general rules

Death benefits can be paid under a personal pension. The amount and type of death benefits payable will depend upon the rules of the scheme and, in the case of retirement benefits, the type of benefit being drawn (e.g. annuity or drawdown pension).

Unused pension funds can be passed to a wide range of potential beneficiaries, whether they are related to the deceased or not. Furthermore, when the beneficiary subsequently dies, any remaining funds that they designated for beneficiary's flexi-access drawdown can be passed onto others (successors).

The rules surrounding who these benefits can be passed on to, and the format in which they may be passed on, are complex.

2.1 The rules

The income tax position applicable to pension death benefits is dependant on whether the member, beneficiary or successor (as applicable) dies before age 75 or after.

	Die before 75	Die after 75
Lump sum	Tax-free within 2 year rule and within the lump sum and death benefit allowance	Marginal rate of tax for individual and 45%* for the trust
Income	Tax-free	Marginal rate of tax on individual

Tax-free lump sum benefits are restricted by the deceased individual's remaining lump sum & death benefit allowance.

*Some of this tax may later be recovered by a beneficiary receiving a distribution from the trust (when the beneficiary is taxed on such distribution as their income).

2.2 Dependants, nominees and successors

Under legislation applicable to pension arrangements, it is possible for death benefits to be paid from a pension arrangement to a wide range of potential beneficiaries. However, there are some restrictions.

Generally death benefit lump sums can be paid to anyone, whereas death benefit pensions (such as flexi-access drawdown or a beneficiary's annuity) can only be paid to someone who is a 'dependant', 'nominee' or 'successor' (as those terms are defined in Schedule 28, part 2 of the Finance Act 2004). Broadly speaking:

- a 'dependant' includes the member's spouse or civil partner, a child of the member who is under the age of 23 and any other person who was financially dependant on the member, or dependant on the member due to physical or mental impairment.
- a 'nominee' is a person nominated by the member in respect of the pension or (if there are no living dependants or persons nominated by the member) a person nominated by the scheme administrator; and
- a 'successor' is a person nominated by a previous beneficiary in respect of the pension or (if there are no living persons nominated by the beneficiary) a person nominated by the scheme administrator.

2.3 IHT and pension death benefits

Currently most pension funds are free of IHT as they are paid out under the discretion of the trustees or a scheme administrator and, as such, currently they are not usually considered to form part of the deceased's estate. The rules regarding this will change from April 2027. After the change, most types of unused pension funds will form part of the deceased's estate for IHT purposes and therefore will be subject to IHT unless one of the usual IHT exemptions applies (for example the spousal exemption). Currently, keeping funds within the pension wrapper may be considered a tax-advantageous way of passing wealth to the client's family. The change in the IHT position in 2027 may impact the tax position significantly. Clients should take specialist advice to consider the impact of this.

2.4 Nominating a charity

A charity lump sum death benefit is tax free. A charity lump sum death benefit can only be paid where there are no surviving dependants of the member. If the lump sum is being paid because of the death of a dependant, nominee or successor it must be paid to either:

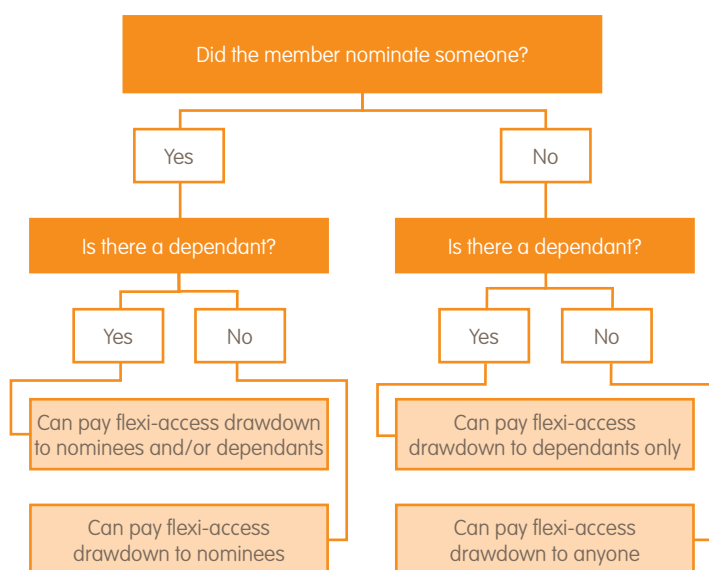
- a charity selected by the member or,
- if the member had not chosen a charity, a charity selected by the dependant, nominee or successor.

If the above conditions are not met, a payment can still be made to a charity, but the tax treatment of the payment will be different. If the member dies under age 75 then the payment will generally be tax free (subject to the two-year limit and the member's remaining lump sum and death benefit allowance), if the member died over age 75 the payment is likely to be subject to the special lump sum death benefits charge of 45%.

2.5 The importance of nomination

Many pension schemes are set up under a discretionary trust. Therefore, when a pension scheme member dies they cannot dictate who receives unused pension funds, instead the scheme trustees and administrators have the discretion to decide who the beneficiary(ies) are.

However, the member (or beneficiary) can express their wishes about who should inherit pension funds. The expression of wishes will be an important factor that is considered in determining who the beneficiary(ies) will be, it's therefore important that the member (or beneficiary) completes a nomination form. If they do not nominate someone and there are dependants, the scheme administrator may only be able to pay a lump sum to any non-dependant (i.e. flexi-access drawdown would not be available to the non-dependant).



Members should make sure they keep their nomination forms up-to-date. It's important they nominate who they want to receive benefits.

3. An overview of the Nucleus Discretionary Bypass Trust

3.1 What is the Nucleus Bypass Trust?

The Nucleus Bypass Trust is a discretionary trust to which death benefits can be paid in respect of a member of the Nucleus Pension account. Using a Bypass Trust means that the scheme administrator at its discretion could pay a lump sum payment of the pension benefits to the trust rather than to the surviving spouse. This would mean that the funds are not in the spouse's estate for IHT purposes. As this is a discretionary trust there can be a wide range of potential beneficiaries who might receive funds from the trust, including the surviving spouse. Please speak to a regulated tax and/or legal professional if you would like further clarification on this.

Provided the member completed an expression of wishes form during their lifetime and indicated they would like the scheme administrator to consider paying the death benefits to the trustees of the bypass trust, it is likely that the scheme administrator will follow the member's wishes unless they find compelling reasons not to.

3.2 How is the Nucleus Bypass Trust established?

The Nucleus Bypass Trust is established during the lifetime of the pension account member and contemplates that the property initially made subject to the trust will be a nominal sum, e.g. £10, and no additions will be made until after the death of the settlor (the member) when the pension account death benefits are paid to it. The £10 is usually covered by a gift exemption but please keep a record of all gifts made as entry charges could be due depending on the circumstances of the individual. Even though the sum is nominal, it is essential that it is transferred to the trustees to ensure that the trust is properly established. It is recommended that anyone who also wishes to carry out other IHT planning with lifetime gifts should use a separate trust.

Once the Nucleus Bypass Trust is established, it is then in place to receive the payment of any death benefits under the Nucleus Pension account at the scheme administrator's discretion on the member's death.

3.3 What type of trust is the Nucleus Bypass Trust?

The trust is a discretionary trust, which gives the trustees wide powers as well as full discretion to appoint the trust property to a wide range of potential beneficiaries. The pension account member will declare the trust during their lifetime and so become the settlor of the trust. The trust document requires the settlor to insert the names of the default beneficiaries when establishing the trust. These are the people who will benefit in the very unlikely event that the trustees do not appoint the trust fund to other beneficiaries within the trust period. It would be usual to include the member's children as default beneficiaries. Alternatively, a charity could be named.

The member's widow(er), as well as the member's children, grandchildren and other specified individuals, are included amongst the discretionary beneficiaries.

To avoid adverse tax consequences during the settlor's lifetime, neither the settlor nor the settlor's spouse may benefit from the trust in any way. The fact that the settlor's widow(er) is one of the beneficiaries has no adverse tax consequences. The Bypass trust should not be used to make further gifts to the trust before the death of the settlor. If the individual wishes to do further trust planning then a different type of trust should be explored.

The trustees have wide powers to invest the funds received by them and they should seek advice on the most appropriate assets to hold as trust property and seek to understand all the registration and reporting requirements involved.

3.4 Nomination of pension death benefits

Where a member of a Nucleus Pension account wants the death benefits to be paid as a lump sum to a Nucleus Bypass Trust created during their lifetime, the member should indicate this on a nomination form, to the Nucleus scheme administrator. There can be no guarantee that the scheme administrator will follow the member's wishes, but they will normally do so.

Please ensure all nominations are reviewed regularly and kept up to date, especially given the changes to the IHT treatment of unused pensions from April 2027.

3.5 Letter of wishes to trustees of the Nucleus Bypass Trust

The pension account member will be the settlor of the bypass trust. The member would normally complete a letter to indicate to the trustees of the Nucleus Discretionary Bypass Trust who should be considered as the primary beneficiary(ies). The trustees are not bound by these wishes though they could consider this when making their decisions about distributing the trust property.

3.6 Accumulation and perpetuity periods

Following the introduction of the Perpetuities and Accumulations Act 2009 (PAA 2009), the perpetuity period for all trusts established under the law of England after 5 April 2010 – including the Nucleus Discretionary Bypass Trust – is 125 years from the date the trust is established. There is no longer any maximum accumulation period (except for charitable trusts).

3.6.1 The Nucleus Pension account

The Nucleus Pension account is governed by a trust that is subject to the law of Scotland. Under the law of Scotland there is no perpetuity period. There is also an accumulation period of 21 years. This means that if a member becomes a member of the Nucleus Pension account and pays contributions (as opposed to just transferring benefits) they will be treated as creating a trust of the benefits representing those contributions and that trust will be subject to the law of Scotland. That 'individual' trust will therefore have no perpetuity period and a 21 year accumulation period.

Please note, section 45 of the Trusts and Succession (Scotland) Act 2024 will remove accumulation periods for Scottish trusts that are established after the date it comes into force. At the time of writing, this date has not been confirmed.

3.6.2 The terms of the Bypass Trust

Clearly, a number of permutations can arise depending on the circumstances of a particular case.

To cater for all of these permutations, the trust has been drafted:

- (a) as regards the initial nominal trust property, to give effect to the position under the new law in England (i.e. a perpetuity period of 125 years and no accumulation period)
- (b) as regards the property received from the pension scheme, to automatically adopt the appropriate perpetuity and accumulation periods depending on the source of the pension scheme assets. This will take account of when the member was deemed to create a trust (under English law) and whether the pensions trust was subject to the law of Scotland.

This means that in cases where lump sum death benefits are paid to the trust, the rules that apply to the perpetuity period and accumulation period of income on these assets may be different from the rules that apply to assets that are placed in the trust when it is established. It is therefore important that the trustees are able to distinguish between these different parcels of property within the trust and keep appropriate records. This could also be important for IHT calculation purposes at the 10-year principal charge anniversaries. The pension scheme member and the trustees of the bypass trust should seek legal and tax advice regarding the accumulations and perpetuity periods and how they apply.

4. The taxation implications of the Nucleus Discretionary Bypass Trust

In the following section, it is assumed that the settlor, the beneficiaries and the trustees of the trust are UK resident and domiciled. Special rules apply where this is not the case.

4.1 On execution of the Nucleus Bypass Trust

The member of the pension account would normally establish a Nucleus Discretionary Bypass Trust. They would therefore be the settlor. The inheritance tax implications would be as follows:

4.1.1 Gift to trust

The creation of the trust will give rise to a transfer of value by the settlor for IHT purposes. However, on the basis that only a nominal gift of £10 is made, this should fall within the settlor's available annual exemption and be exempt from IHT.

It is recommended that the Nucleus Discretionary Bypass Trust is established with only a nominal amount and no other funds are added to this trust except the pension death benefits.

Should the transfer to the trust not be covered by an exemption it will be a chargeable lifetime transfer for IHT purposes and entry charges might apply.

4.2 IHT implications whilst the trust is in existence

4.2.1 Before the death of the settlor

Provided the trust is created with a nominal amount and no assets are added to the trust after its creation, there should be no IHT charges while the settlor is alive.

4.2.2 Payment of the death benefit to the Nucleus Discretionary Bypass Trust

The payment of the death benefit from the Nucleus Pension account to the bypass trust will be an additional payment to the trust. Prior to April 2027 there should be no immediate IHT implications on the payment of death benefits to the bypass trust.

It should be noted that if the trustees of the bypass trust then distribute benefits to an individual beneficiary, there could be an IHT exit charge.

As this is a discretionary trust, special IHT charging rules apply. Under these rules there may be a potential IHT charge:

- on every 10-year anniversary of the trust – 'the principal charge' or
- whenever property is distributed to a beneficiary – 'the exit charge'

4.2.3 Principal charge

Principal charges at 10-yearly intervals may be applied to the value of the assets in the trust. The rate of IHT charged will be determined by considering:

- the value of the property in the trust on the 10-year anniversary plus the value of any related settlements (i.e. same-day settlements) when they were established (the assumed transfer); and any additions to the trust
- the settlor's available nil rate band to set against the value of the trust. The nil rate band can be reduced by any chargeable lifetime transfers made by the settlor in the seven years before commencement of the trust and any distributions of capital to the beneficiaries in the previous ten years

In this respect it is important to note that if the lump sum death benefit originates from a pension plan which is subject to a discretionary trust, HMRC will apply section 81 IHT Act 1984 which states that when property moves between different discretionary trusts, the discretionary trusts will be treated as one trust for the purpose of the 10-year principal charge (and exit charge) which commenced when the first trust began. As the member will be treated as creating their own trust when they joined the pension scheme, this means that it is important to establish when the original (pension) trust began in order to calculate any IHT charges.

Tax and legal advice should be sought before establishing a discretionary bypass trusts so the client and their trustees are fully aware of the tax implications and reporting requirements involved.

4.2.4 Exit charge

The calculation of an exit charge depends on when the property is distributed to a beneficiary of the trust.

(a) Exit occurring after a 10-year anniversary

If the exit occurs after a 10-year anniversary, the exit charge is based on the rate of IHT paid at that last principal charge, the value of the distribution and the number of quarters since the last ten-year anniversary.

(b) Exit occurring before the first 10-year anniversary after death

Where property is distributed before the first 10-year anniversary after death, a recalculation must be made of the hypothetical tax charge that would have arisen. Again, due to the complexity involved here the client and their trustees should seek tax advice before making distributions to beneficiaries so they understand the implications and any reporting requirements.

Reporting requirements

All UK express trusts unless excluded need to register on the HMRC Trust Registration Service. This may include bypass trusts and trustees should seek advice to understand their responsibilities to ensure any trust registration is completely correct, proof of registration supplied and the record is kept up to date.

4.3 Special Lump Sum Death Benefits Charge

Prior to age 75, the lump sum death benefits will generally be paid with no deduction of income tax (subject to available Lump sum & death benefit allowance) where it is paid within 2 years of the scheme becoming aware of the member's death.

Post age 75, the lump sum death benefits will be paid to the trust net of a 45% special lump sum death benefit tax charge. To the extent that subsequent payments of capital to the beneficiary are attributable to the pension lump sum death benefits, the 45% tax charge deducted by the pension scheme trustees will be available as a credit to frank the income tax liability. This credit is reclaimable by the beneficiary to the extent that their marginal tax rate is lower than 45%.

4.4 Income tax and CGT implications of the Nucleus Discretionary Bypass Trust following the death of the settlor (after receipt of pension death benefits)

4.4.1 Income tax

Following receipt of the death benefits and investment of this by the trustees, the following income tax implications will arise:

- For income tax purposes, the trustees are treated as the owners of the trust assets and are assessed to income tax on any trust income (e.g. dividends or interest). The trustees currently pay tax at a special trustee rate depending on the source of income. Trusts with income less than £500 in a tax year are not subject to Income Tax.
- Where the trustees distribute income of the trust, that payment will carry a tax credit reflecting income tax paid by the trustees at the trust rate (currently 45%). This is separate from any tax charged on the original pension death benefit payment to the trust. Beneficiaries should seek tax advice on reporting trust income.

4.4.2 Capital gains tax

Depending on where the trustees invest, there may be capital gains tax (CGT) implications. These will occur on the trustees encashing investments to raise cash to pay a beneficiary or on transferring assets out of the trust to a beneficiary, although in the latter case a claim for CGT hold-over relief may be possible. Tax advice should be taken.

Any capital gains arising under the Nucleus Discretionary Bypass Trust will be assessed to tax on the trustees. The trustees are entitled to their own annual CGT exemption, which is currently £1,500, and is equal to one half of that available to individuals if the settlor has created only one trust. If there is more than one trust created by the same settlor after 6 June 1978, the trustee exemption will be apportioned equally between the trusts but it will not fall below £300 per trust.

Any gains arising on the disposal of any chargeable assets held in the trust that exceed the available annual exemption would give rise to a CGT liability at the rate of 24%.

4.5 Loans to beneficiaries

Generally speaking, it is assumed that if loans are to be made to beneficiaries they will be made on an interest-free/repayable on demand basis. Loans can be made to any of the beneficiaries.

There will be no income tax, CGT or IHT implications as a result of such loans leaving aside, of course, any CGT liability that may arise on the disposal of any asset to realise the cash to make the loan.

4.6 Capital appointments out of the trust

If trust capital is appointed to a beneficiary there could be an exit charge for IHT purposes (see earlier).

If the trustees have realised assets to generate the cash, this could give rise to CGT implications.

If assets that are potentially subject to CGT are transferred from the trust, the transfer of those assets to the beneficiary would be treated as a disposal for CGT purposes. However, on the basis that this could potentially give rise to an IHT charge at that time, it may be possible to make an application for CGT hold-over relief to defer a tax charge on any chargeable gain arising on the disposal.

4.7 Gift with reservation rules

As the settlor may not benefit from this trust in any circumstances, the IHT gift with reservation rules, introduced by Finance Act 1986 and which apply to certain settlements, will not apply to the Nucleus Discretionary Bypass Trust.

4.8 Pre-owned assets tax charge

As the settlor may not benefit from this trust in any circumstances, the pre-owned assets income tax provisions introduced by Schedule 15 of the Finance Act 2004, which apply to certain settlements, will not apply to the Nucleus Discretionary Bypass Trust.

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