Pensions and inheritance tax: a consultation

Inheritance Tax and trusts



18 February 2025

The ATT and CIOT have both raised concerns about potential complexities and unintended consequences of the proposals to subject unused pension benefits to inheritance tax.

The ATT and CIOT have both recently responded to the HMRC technical consultation ‘Inheritance tax on pensions: liability, reporting and payment’ (see tinyurl.com/2s3u4r46). The consultation was issued last year, following the announcement at October’s Budget that, from 6 April 2027, any used pension funds or death benefits will be included within the value of an individual’s estate on death and be subjected to inheritance tax (IHT).

Under the proposals, personal representatives (PRs) will be required to liaise with pension scheme administrators (PSAs) to establish the value of unused pension assets and then to allocate a proportion of the nil rate band to each pension fund. Each pension fund will then need to pay their share of IHT to HMRC before personal

representatives can apply for probate.

Although the policy itself was not up for consultation – only the implementation – both the ATT and CIOT have suggested an alternative approach to taxing pension assets.

ATT response

Currently, PRs have little engagement with PSAs beyond informing them that the individual has died. In our response, we raised concerns about the cost, time and stress of the additional administration work the new measures bring, especially if an amendment is needed if assets are discovered after the IHT400 (the form used by PRs for reporting the value of assets in an estate liable to IHT) has been submitted.

The need to resolve the IHT position first – including to confirm that none is due – is likely to delay when PSAs can pay income or lump sums out to survivors. This could cause cashflow issues for some surviving spouses/partners.

The measures may also catch out unmarried couples who were envisaging that any undrawn pension assets would be available to support the survivor. As it stands, an individual with a defined contribution scheme could choose to nominate an unmarried partner to receive pension benefits after their death. Currently, the surviving partner only needs to consider any potential income tax implications, which will depend on how old their partner was at their death. But from 6 April 2027, the funds may first be reduced by an IHT charge. Married couples in contrast can continue to leave pension assets to each other free of IHT.

Given the administrative challenges, we think there would be merit in exploring a separate IHT regime for pensions which would help to meet the government’s policy intention, without creating excessive burdens on PRs.

CIOT response

Although we commented extensively on the technical details of implementing the current proposals, we concluded that they are unworkable because there are so many working parts in an integrated IHT regime. Repeated liaison between the PRs and the various PSAs would be required whenever an additional estate asset was

reported or a valuation changed, and whenever a further pension fund was discovered (the likelihood of the deceased holding a number of pensions is increasingly common). There would be delay in the process of PSAs determining how to exercise their discretion, and then in making payment to beneficiaries. The greater administrative burden on PSAs would inevitably have a financial impact on consumers in the form of increased charges.

We suggested an alternative approach, which is grounded on two premises. The first is that pensions (and the associated tax regime) are intended to provide for the member and their dependants following retirement by age or ill-health. The second is that the government's policy intention is to 'bring most unused pension funds and death benefits' into a tax charge on the member's death.

We recommended that this policy objective be achieved through an alternative approach of a separate inherited pension death benefit charge (IPDBC) payable by the PSA when the unused pension or death benefit passes to a beneficiary who is neither a spouse nor a dependant of the scheme member. There would be no need for the PRs to identify the deceased's unused pensions, or to supply any estate information to the PSAs. The PRs would administer the estate and deal with any IHT liability (as now) with little concern for the pension.

Each PSA would be solely responsible for ensuring the IPDBC is paid in respect of their own fund, without having to be concerned about other pensions and the free estate. The payment of the IPDBC could be dealt with through the form that PSAs already use to report any income tax liability to HMRC (the Accounting for Tax return), which PSAs are familiar with. This would negate the need (and cost) of setting up a separate, parallel IHT system. This approach gives certainty to the PSA and obviates the need for further adjustments.

We envisaged that the IPDBC be charged when the deceased member's fund passes to a person who is not a dependant as defined in FA 2004 Sch 28 para 15 for the purposes of a dependant's scheme pension. This would afford consistent treatment for the death benefits of defined benefit and money purchase (defined contribution) members. Broadly, a dependant is a spouse or civil partner; a member's child under 23, or 23 and over and dependent because of physical or mental impairment; or anyone else who was financially dependent on the member. The IPDBC would 'bite' when the fund passes to persons outside of that definition, typically to adult, self-sustaining children. Unused pension funds would therefore cease to be available as

a tax planning tool to transfer wealth.

As all unused pension funds would be subject to the IPDBC (without the benefit of the deceased member's apportioned IHT nil-rate band), we suggested that the first £30,000 (mirroring the trivial commutation limit) be exempt. To avoid exploitation, that single allowance could be applied to all pension funds under the control of one PSA.

Recognising also that the IPDBC approach potentially brings into charge some unused pension funds which, even when aggregated with the deceased's free estate would have not incurred IHT, we suggested that the rate of IPDBC could be set lower than 40%, perhaps at 30% or 35%, to compensate. When determining the appropriate rate, the government would have to balance the attractiveness of imposing a rate equivalent to IHT with the fact that a basic rate or non-taxpayer might be more heavily taxed on their death in respect of their contributions than any relief they were given on making those contributions.

We concluded that an IPDBC designed along these principles would meet the government's policy objectives without the immense practical difficulties and costs associated with their IHT proposal.

The full ATT response can be found here**:** www.att.org.uk/ref471

The CIOT response can be found here: www.tax.org.uk/ref1404

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