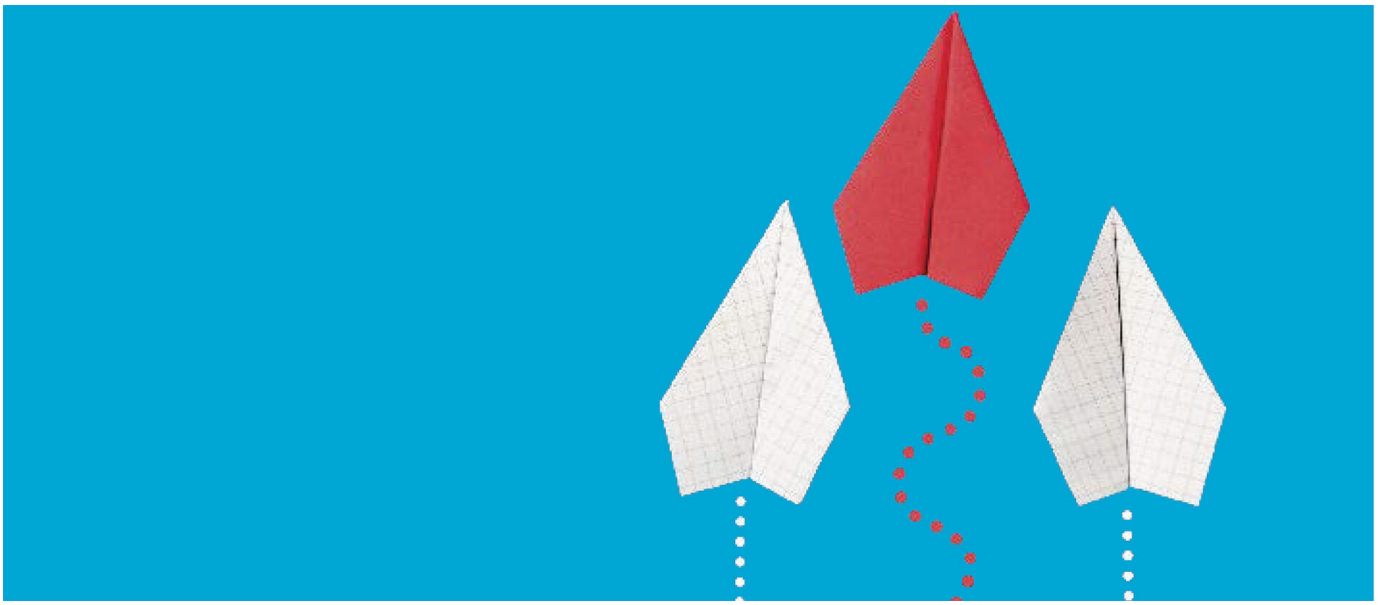
Pensions and inheritance tax: revisiting assumptions

Personal tax | Inheritance tax and trusts



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From April 2027, major reforms will integrate pension funds into the inheritance tax net, altering longstanding planning assumptions and raising new administrative challenges.

Key Points

What is the issue?

From April 2027, pensions will become subject to inheritance tax, ending their longstanding exemption and changing how they fit into estate planning. This shift means executors, not pension administrators, will be responsible for reporting and paying the tax, creating new administrative and financial challenges.

What does it mean to me?

If you hold significant pension wealth, it may now face inheritance tax when you die, reducing what passes to your beneficiaries. You and your executors will need to plan carefully for liquidity, administration and potential double-taxation risks.

What can I take away?

Review your estate plans, pension nominations, and executor choices well before the 2027 implementation date. Early, proactive planning with advisers can help to minimise tax exposure and ensure your estate is administered smoothly under the new rules.

The government’s draft legislation on the inheritance tax treatment of pensions represents one of the most far-reaching changes to estate and pensions taxation in recent memory. Initially announced in the Autumn Budget in 2024, the new rules which were published in August, following consultation earlier this year, are expected to raise £1.46 billion by 2029/30.

However, their implications go far beyond fiscal yield for tax professionals and financial advisers. They raise intricate compliance and administrative questions. Perhaps even more significantly, they will change longstanding assumptions about how pensions fit into intergenerational wealth planning.

A new chapter for pensions and inheritance tax

From April 2027, pension funds will fall within the scope of inheritance tax, even where scheme trustees or administrators retain discretion over the payment of death benefits. In policy terms, this is a clear departure from the framework established under the 2015 pension freedoms, which cemented the idea that undrawn pension funds should generally remain outside the estate for inheritance tax purposes.

This change is not merely technical. For decades, pensions have been viewed as one of the most effective vehicles for intergenerational wealth transfer, a tax-efficient ‘safe harbour’ where assets could accumulate without falling into the inheritance tax net. That treatment has encouraged both advisers and clients to leave pensions untouched for as long as possible, drawing instead on taxable assets first.

Under the new regime, that logic no longer holds. Pensions will be treated like other assets for inheritance tax purposes, and advisers must now revisit the assumptions underpinning retirement and estate planning strategies.

Personal representatives take centre stage

One of the most striking elements of the draft legislation is the shift in responsibility for inheritance tax reporting and payment. Initially, pension scheme administrators were expected to bear this obligation.

However, after significant industry lobbying, the government confirmed that personal representatives, executors or administrators of the deceased’s estate will instead be responsible for reporting and paying any inheritance tax due on unused pension funds and death benefits.

This outcome will be welcomed by pension scheme administrators, who are now relieved of an administrative and legal burden. For personal representatives, however, the consequences are far more challenging. They will be liable for tax on assets they do not control, may not even know exist at the outset, and cannot directly access.

In some cases, personal representatives may need to pursue beneficiaries or scheme administrators to recover inheritance tax they have paid from the estate’s free assets. This could create serious cash flow and timing pressures. Executors may struggle to fund liabilities before probate is granted, risking high interest charges on unpaid tax. Even relatively straightforward estates could face longer administration periods, particularly where multiple pension arrangements are involved.

There is also a behavioural dimension to this. Given the increased risk and complexity, some individuals may be less willing to act as executors in future, especially for large or intricate estates that include substantial pension wealth.

Reliefs, exemptions and structural challenges

Certain longstanding reliefs remain intact. Transfers of pensions to a spouse, civil partner or charity will continue to be exempt from inheritance tax, and death-in-service benefits paid from registered schemes will stay outside the tax’s scope.

However, pensions will not benefit from business property relief or agricultural property relief, even if the underlying assets within the pension would qualify for relief if held directly. For clients with trading businesses or agricultural holdings within their pension portfolios, this will significantly reduce flexibility and could have unintended consequences for diversification and liquidity planning.

A new statutory mechanism will allow beneficiaries to request that the pension scheme administrator pays inheritance tax directly from the pension fund, but only where the tax exceeds £4,000. This could provide some practical relief, yet the right is limited. Personal representatives cannot make such a request on behalf of minors or beneficiaries lacking mental capacity, a restriction which is likely to create real difficulties in practice. Many pension nominations include young children or dependants, and advisers will need to plan carefully around this.

If personal representatives instead settle the liability from the free estate, they retain a statutory right to reimbursement from the beneficiary or pension fund. However, in practice this means funding the payment upfront and seeking recovery later, not an attractive prospect in large or contested estates.

Finally, while pension scheme administrators have avoided direct tax responsibilities, they are not entirely off the hook. If a pension scheme administrator fails to comply with a valid beneficiary request to pay inheritance tax, they may become personally liable for the tax due. Trustees, however, are protected unless they also act as administrators.

Administrative and technical complexities

The draft legislation introduces several new operational challenges. For example, the nil-rate band will need to be apportioned across the free estate, settled property and pension funds. This could complicate calculations and lead to disputes, particularly if additional pensions come to light after initial returns have been filed. Personal representatives may be reluctant to finalise distributions until all pensions have been confirmed, further delaying estate completion.

There are also unanswered questions about valuation methodology, the treatment of defined benefit schemes, and the interaction between inheritance tax and income tax when pension assets are used to pay the tax itself. The government has confirmed that where inheritance tax is settled from a pension, the corresponding

income will be reduced for income tax purposes.

Whilst this is helpful, it applies only to inheritance tax on the pension in question, not to liabilities on other assets paid using pension withdrawals. In those cases, beneficiaries could face a double tax drag: income tax on withdrawals plus inheritance tax on the estate.

Strategic responses: what advisers should consider now

For years, advisers have worked from a straightforward assumption: draw on taxable assets first and leave pensions intact. That assumption will now need to evolve. The shift in policy demands a rethink of how and when pensions are accessed, and how they fit into wider succession planning.

1. Review estate plans comprehensively

Clients whose pensions make up a significant proportion of their total wealth should undergo a full estate planning review. This includes modelling inheritance tax liabilities under the new framework, assessing liquidity shortfalls and stress-testing cash flow for executors.

2. Examine pension nomination forms

Many nomination forms will need to be revisited. In some cases, leaving pensions directly to executors rather than individual beneficiaries may simplify administration and payment of inheritance tax, though this may not always align with personal or family wishes.

3. Address liquidity and funding risk

Executors will need access to cash or liquid assets to fund inheritance tax before probate. Advisers should explore liquidity planning tools, such as life policies written in trust, designated cash reserves or partial drawdowns timed to coincide with probate milestones.

4. Reconsider investment structure

There may be renewed interest in transferring assets out of pensions into vehicles qualifying for business property relief or agricultural property relief, though

valuation, liquidity and market considerations will limit this strategy’s appeal. Others may explore lifetime trusts or family investment companies to achieve flexibility while managing exposure.

5. Monitor lifetime gifting and drawdowns

HMRC has signalled growing concern about individuals withdrawing large sums from pensions to make lifetime gifts. Currently, such gifts can fall under exemptions for regular gifts out of income or as potentially exempt transfers. However, there is increasing speculation that new restrictions could be introduced, especially if HMRC perceives abuse of these rules. Practitioners should watch this space closely, particularly in the lead-up to the Autumn Budget 2025, which may clarify the government’s approach.

6. Strengthen executor selection and guidance

With personal representatives now on the front line, advisers should ensure that clients choose executors capable of handling complex estates, ideally with professional support. It may also be worth revising letters of wishes or appointment documents to make explicit reference to pension-related inheritance tax liabilities.

Behavioural and market impacts

The Treasury’s forecast assumes minimal behavioural change, and that individuals will continue to hold pension wealth as before, simply paying more tax on death. In practice, behavioural change is inevitable. The inclusion of pensions within inheritance tax fundamentally alters incentives.

Some clients may accelerate withdrawals to reduce taxable pension balances before death, particularly if their marginal income tax rate is lower than the effective inheritance tax rate. Others may use pension funds for lifetime gifting or reinvestment into relievable assets, such as trading companies or farmland, although this carries its own risks and complexities.

At the institutional level, pension providers and administrators will need to update systems, documentation and communications to reflect the new regime, particularly around nomination forms and death benefit processes. The administrative burden on trustees and personal representatives alike will increase.

There could also be an indirect impact on pension saving behaviour. Some individuals, especially those with larger estates, may see pensions as less attractive once they lose their relative inheritance tax advantage, potentially shifting capital into ISAs, investment portfolios or trusts. Advisers will need to balance these considerations carefully against income tax, capital gains and contribution limits.

Key technical questions that remain

Several areas of the legislation are still open to clarification or amendment. Among them are the timing of liability and the valuation basis of defined benefit schemes and illiquid assets.

Finally, questions remain around double taxation and transitional rules, whether any further relief will be provided to prevent overlapping income and inheritance tax charges on the same funds, and how pensions drawn down or partially crystallised before April 2027 will be treated.

Until HMRC issues detailed guidance, advisers will need to make pragmatic assumptions based on existing inheritance tax principles and prior case law.

Practical steps before 2027

Although April 2027 may seem distant, advisers will need to start preparing clients for these changes now. Steps to consider include early engagement with executors and trustees to clarify responsibilities, data gathering to identify all pension schemes and death benefit arrangements within client portfolios and scenario modelling to estimate potential inheritance tax exposure and liquidity needs.

Client communication to explain the upcoming changes and manage expectations and coordination with legal advisers to ensure wills, trusts and nominations align with the new framework will also be required.

The introduction of inheritance tax on pensions represents both a compliance challenge and a strategic opportunity. Advisers who act early will be best placed to guide clients through a complex transition.

Looking ahead

The government’s reforms mark a decisive shift in the UK’s approach to pension taxation, one that will blur the longstanding boundary between retirement planning and estate planning. What was once a protected asset class will now demand the same level of attention and precision as other components of a client’s estate.

As the policy landscape evolves, the most effective advisers will be those who can interpret complexity into actionable guidance: helping clients to structure estates efficiently, maintain liquidity and preserve family wealth despite a tightening fiscal environment.

Pensions are no longer immune from inheritance tax. Tax professionals will need to demonstrate technical expertise, foresight and proactive planning in order to prepare their clients for these changes.

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