Finance Bill 2025-26

Representation from the Association of Taxation Technicians (ATT)

Clause 63 - 67: Inheritance Tax: Pension interests

Executive Summary

These measures bring the value of unused pension pots and some other death benefits into scope for Inheritance Tax (IHT) for deaths occurring on or after 6 April 2027. The stated purpose of the rules is to prevent individuals using pensions as a route to pass wealth free of IHT onto the next generation. Pension assets left to spouses or civil partners will remain exempt from IHT in line with other assets.

Whilst there have been some welcome changes announced at Budget 2025 (included in Clause 64 and 65) to help reduce the risks to Personal Representatives (PRs) these measures will still be complex to apply in practice and clear guidance for both PRs and Pension Scheme Administrators (PSAs) will be essential.

To help PRs better manage the payment process we would like to see:
- PRs allowed to apply for a longer withholding period (if needed) to reduce the risk of pension schemes paying out benefits before the PRs have had time to finalise the IHT liabilities.
- The removal of the £1,000 minimum threshold for direct payments by pension schemes to HMRC.
- The option to pay by instalments where the pension holds illiquid assets such as commercial property.

For the purposes of assessing if the reduced rate of IHT applies (which requires at least 10% of the net estate to be left to charity) we would like to see pension assets considered as a separate component of the estate.

On a wider point, we are concerned that the changes may lead to unfortunate consequences for some unmarried couples. Currently unmarried couples can leave pension wealth to each other without IHT consequences but they now risk losing value from pension assets which they may not have planned for. Clear guidance is needed.

Finally, it is disappointing that the Government did not consult on alternative, pension-specific measures, decoupled from the individuals’ wider IHT position, to tackle the concerns around using pensions as a tax-efficient wealth transfer vehicle. Fundamentally, even with the changes introduced by Budget 2025, PRs are still being asked to manage IHT payments on assets over which they do not have full control.

1. Background [Clauses 63-67]

1.1. Clauses 63 - 67 introduce measures to apply Inheritance Tax (IHT) to unspent pension assets and other death benefits for deaths occurring on or after 6 April 2027. Unspent pension assets in discretionary, defined contribution schemes can currently be left IHT-free.

1.2. The changes will create additional work for Personal Representatives (PRs), who are the individuals legally responsible for managing and distributing the deceased person's assets according to their will (where one exists) or under intestacy rules (if one does not). PRs are also known as executors or administrators. PRs can be professional advisers, or may be relatives or friends of the deceased with no relevant training or professional experience in this area. The PR is responsible for taking control over the estate, applying for probate (if needed), notifying beneficiaries, paying debts and filing necessary legal documents.

1.3. Following the introduction of these measures, PRs will be responsible for obtaining the value of pension assets held by the deceased from the Pension Scheme Administrators (PSAs), calculating the additional IHT due on the estate due to pension assets, and ensuring that payment is made in respect of those assets.

1.4. Clause 63 identifies what pension interests should be included in the estate and how to calculate the value of *notional pension property* which will be subject to IHT. It sets out exclusions for certain payments including those for *dependants' scheme pensions* and *dependants' and nominees' annuities*. Schemes set their own definitions of who is a dependant and not all schemes offer dependant's scheme pensions. Typically a 'dependant' will include a spouse, civil partner or child under 23 but can, depending on the terms of the scheme, include an unmarried partner. This clause also excludes certain death-in-service benefits from IHT.

1.5. Clause 64 places the liability for paying any IHT due on pensions on the PRs, even though PRs do not have control of pension assets - as they do for most other assets in the estate. The PSAs can also be made liable in limited circumstances. These circumstances include if they have paid out benefits in breach of a notice asking them to withhold or they have not complied with a notice from the PRs or the pension beneficiaries to make payment to HMRC. Where pension beneficiaries have received benefits from the pension and the PRs have made payment of IHT relating to those benefits, the PRs have a right of recovery from the pension beneficiaries.

1.6. Following changes announced at Budget 2025, Clause 64 also includes a welcome measure to protect PRs where further pension assets are found after the estate has been wound up. PRs will not be liable for any IHT on pensions which are discovered after clearance has been granted. (Clearance is given by HMRC at the point where HMRC agrees that all tax has been settled.) This protection is subject to the PR making reasonable efforts to ensure all the deceased's pensions are identified during the administration process. However, PRs will still be responsible for calculating any extra tax due, which is likely to incur costs (either to pay professional executors, or for executors who are family or friends to pay for professional advice) at a point when nothing remains in the estate. Given that pension assets are frequently lost or forgotten, it is possible for pension assets to be identified months or years after death.

1.7. Clause 65 also includes changes made at Budget 2025 following representations to Government by a number of bodies. It allows PRs to ask the PSA to withhold 50% of the pension assets for up to 15 months from the end of the month of death where they have reason to believe IHT will be due. PRs, as well as pension beneficiaries, can then ask PSAs to make direct payment of IHT and any associated interest due on those assets to HMRC once the IHT liability has been calculated. This gives PRs a window of time to establish the IHT on the estate. After the 15 months have elapsed, if further IHT is due on pension assets the PRs will need to ask the pension beneficiaries to make payment or pay it themselves and then try to recover it from the pension beneficiaries. This recovery brings risk and could be expensive if the pension beneficiaries are not co-operative and impossible if the beneficiaries are overseas.

1.8. Clause 66 makes further amendments to the Inheritance Tax Act 1984 (IHTA 1984) including confirming that gifts from pension schemes to charities are not subject to IHT.

1.9. Clause 67 makes amendments to income tax legislation to allow pension beneficiaries to claim a refund of any income tax paid on funds taken from the pension which they then use to pay some or all of their share of IHT.

2. **Overall approach**

2.1. The Government's intention behind the policy is to ensure that pension schemes are not used as a vehicle to transfer wealth IHT-free down the generations. Given this objective, we think that if the Government had consulted on this specific point it would have allowed for a wider range of suggestions than bringing pensions into the IHT regime.

2.2. The pension ecosystem is already complex, involving a number of different advisers. Pension scheme administrators, pension trustees and financial advisers do not necessarily have knowledge and experience of the probate process. Equally probate professions do not usually have the relevant qualifications to advise on pensions. From a practical perspective, bringing unused pension funds and death benefits within the individual's estate for IHT purposes means that many families will need to seek advice from a range of different experts, who all need to work together. Similarly, PRs will need to take advice from and engage with a range of other professionals.

2.3. We think the Government should have consulted on pension-specific measures to tackle the perceived abuse, and decouple this from the individuals' wider IHT position.

2.4. We are concerned that those who will come into the IHT regime for the first time as a result of including their pensions may not be aware of the potential extra tax costs. They may previously have been told that IHT is not an issue for them. Unadvised individuals in particular are unlikely to appreciate the potential impact on their residential nil rate band, which is reduced once the estate (including pension assets) exceeds £2 million.

2.5. Something simpler such as a flat rate charge on unspent assets would have broadened the asset base and been easier to administer, without imposing additional obligations on PRs.

3. **Withholding of benefits by the scheme administrator [Clause 65]**

3.1. Where the PRs know, or have reason to believe, that tax will be due on pension assets in the estate, section 226A allows for PRs to give notice to the PSA and ask them to withhold 50% of the pension assets for up to 15 months from the date of death. This is intended to allow PRs time to establish the IHT due on the estate and ensure that the PSA retains sufficient funds in the pension fund to pay the IHT due on those assets.

3.2. For complex estates - especially those where valuations of business assets are needed which can take significant time to agree with HMRC - this may not be sufficient to finalise the IHT liability. It would be helpful if PRs could apply for a longer period of withholding in complex circumstances. One approach would be to allow PRs to apply for withholding for up to 24 months.

3.3. That said, we appreciate that PSAs will not want to hold assets for a long period in all cases, and we have seen others suggest imposing conditions to limit longer periods of withholding to complex estates. That would place a burden on either the PSA or HMRC to review if those conditions are met.

3.4. Our recommendation is that the initial withholding is left at 15 months, with PRs having the option to make a second application after one year has passed to extend the withholding for a further nine months, for an amount of 'up to' 50% of fund assets. This would bring withholding to a potential maximum of 24 months from the end of the month of death while allowing some funds to be released if the PRs are not expecting the full 50% to be required.

4. **Payment of tax by the scheme administrator [Clause 65]**

4.1. Section 226B allows for the PR or pension beneficiary to ask the PSA to make a payment of tax direct to HMRC. Tax in this instance can include both the IHT due on the pension assets and any interest if IHT is paid after the six-month deadline. S226B(3)(b) sets the minimum amount that PRs can request at £1,000.

4.2. Given that PSAs will have had to set up systems for direct payment regardless, we think that the inclusion of a de minimis figure is unhelpful. This will particularly be an issue if payment is made late, and interest is accruing. In this case it will be hard for PRs to provide an accurate figure for the PSA to pay as interest accrues on a daily basis, and PSAs have 35 days from the date of the notice to pay - during which time further interest will accrue.

4.3. Where the additional interest is more than £1,000, the PRs can make a further application for the PSA to pay it. If the interest is less than £1,000, either the PRs can decide to fund the interest out of the general estate (which means that the residuary beneficiaries end up bearing the cost) or ask the pension beneficiary to pay it either directly or via reimbursement. The pension beneficiary in turn will likely want to recover any income tax paid on pension monies used to pay IHT and will need to make a claim which HMRC will then need to process.

4.4. Removing the lower limit on the amount of IHT that PSAs can be asked to pay out would simplify matters for PRs, pension beneficiaries and HMRC.

5. **Payment of tax by the scheme administrator [Clause 65] – lack of option to pay by instalments**

5.1. Once a PSA has been instructed to make a payment of IHT, s226B(2) gives the scheme administrator 35 days from the date of receipt to make payment.

5.2. This deadline may be challenging or impossible to meet in some cases where the assets are illiquid. For example, where the pension is a SIPP which holds commercial property. The pension scheme administrators may not wish to or be able to sell the property – and where the property is occupied by a company or business owned by the deceased or otherwise connected to the family, the family may not wish to sell the premises.

5.3. We think it would be helpful if it was possible to apply to pay IHT arising on illiquid pension assets in instalments. The instalment option allows IHT to be paid over a period of 10 years and would be available to the PRs if any property assets were held directly.

6. Application of the reduced rate of IHT for estates leaving gifts to charity

6.1. Gifts to charity are fully exempt from IHT under section 23 IHTA 1984. In addition, where an estate includes a significant gift to charity, it is possible that some or all of the remaining estate can benefit from a lower rate of IHT provided that the gift is large enough. The lower rate is 36% compared to 40%. This lower rate was introduced to encourage individuals to consider gifting via their will.

6.2. To assess if the gift is large enough for the reduced IHT rate to apply, the gift must be more than 10% of a ‘base line’ amount – very broadly, the net estate after deduction of allowances such as the nil rate band.

6.3. To complicate matters, the test is not applied to the estate as a whole. Instead the estate is divided into three components. It is possible to meet the test in one component and receive the reduced rate in that component alone. Alternatively a gift in one component can be large enough that an election can be made for one or more of the other components to qualify for relief.

6.4. The estate is divided into the following three components:

- Amounts left by survivorship – very broadly, assets which are left to surviving joint owners, outside of the will
- Settled assets – this includes assets in which the deceased had an interest in possession
- The general component of the estate – broadly any other assets comprised in the estate.

6.5. We expect that as the draft legislation stands, notional pension property (as defined in 1.4) will form part of the general component.

6.6. Individuals who have arranged to gift 10% of the general component may now find that the inclusion of their pension assets will cause them to fail the test to achieve the reduced rate. They will either have to increase their gifting (which they may not be willing to do) or lose the benefit of the reduced rate.

6.7. In order that individuals are not discouraged from gifting to charity on their death we would like to see notional pension property considered a separate ‘component’ for the tests for the 36% rate. This ‘component’ should be eligible for the same mechanisms that allow individuals to ‘merge’ components where a gift in one component is big enough to allow two or more components to meet the criteria for the 36% rate. This would protect existing planning for some and allow greater flexibility on gifting for others.

6.8. This should protect access to the reduced rate for those who have planned to make gifts under the existing rules, while enhancing the flexibility for those who are motivated to make charitable gifts to reduce IHT on their pension assets only.

6.9. Such a change could form part of the connected amendments to IHTA 1984 in Clause 66.

6.10. For completeness, we are waiting for confirmation from HMRC that notional pension property *will* form part of the general component. In the event that HMRC does not agree with our analysis, our recommendation still stands on the grounds that we think charitable gifting from pensions should be considered separately from the other components of the estate and that specific provisions are needed to achieve this.

7. **Implications for unmarried couples**

7.1. Transfers of pension assets between married couples and civil partners will remain IHT-free, in line with the position for other assets. Unmarried couples have always run the risk of paying IHT on the first death, but the new measures will mean couples who have been together for many years and anticipate making financial provision for each other via pensions will need to reconsider their options. The potential loss of value in the pension to IHT will be particularly acute if one member of an unmarried couple dies in their 50s or 60s when pension assets are at their peak value and expected to provide an income throughout the survivor's retirement. The loss of up to 40% of the fund in these circumstances could be significant for the survivor.

7.2. Provision has been made to exclude *dependants' scheme pensions* from IHT. A dependants' scheme pension can include unmarried partners, but in practice depends on the individual scheme rules. Dependants' scheme pensions are more common in the defined benefit schemes seen predominately in the public sector and less so in the defined contribution schemes which predominate in the private sector. We do not know the extent to which it is possible for pension schemes to amend their rules or how much consideration individuals give to the scheme provisions for unmarried partners prior to retirement. We think that further discussion with pension scheme administrators should be undertaken to see what steps PSAs are taking to manage the risks for unmarried couples and clear guidance will be needed.

Association of Taxation Technicians
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Note:

The Association of Taxation Technicians

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Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

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