

Inheritance Tax on Pensions: Draft Legislation Sets Out Next Steps



Despite pushback from the financial services industry, the UK Labour government is still forging ahead with plans to apply Inheritance Tax (IHT) on unused defined contribution pensions from April 2027.

Although consultation responses proposed an exemption for small value pension pots, HMRC has confirmed that all unused pension funds, regardless of their value, will be within scope for IHT reporting.

The original proposals only referenced UK registered pensions; however, we now know that legal personal representatives will also be required to report the value of any QNUPS and pay any IHT due. Clearly, added clarity is needed on the impact of this with non-UK Long Term Residents under the new April 2025 rules and on the treatment of their pensions holding any assets deemed to be non-UK situs.

There have however been some changes to the original proposals, after their consultation came to a close in January 2025. For example, legal personal representatives rather than pension scheme administrators, will be liable for reporting and paying HMRC where any IHT is deemed due.

In addition, death in service benefits payable from a UK registered company pension scheme will remain out of scope of IHT. These are the benefits that are usually paid as a lump sum to a nominated family member, equivalent to a multiple of an employee's salary, if they die whilst still in employment.

It should be welcomed that HMRC has made some amendments to its original proposals, however it is very disappointing that it has not listened to some strong industry views put forward that using IHT on pensions as a revenue generator, is potentially not a simple option. This will no doubt result in a complex process that could cause bereaved family's confusion and stress at what is already a difficult time – particularly for people likely to be vulnerable following the death of a family member.

The government has countered this in a recent policy paper that stated 'most estates' would continue to have no IHT liability after April 2027. It estimated that 10,500 additional estates will have an IHT liability, with 38,500 estates paying more IHT than would previously have been the case. The result is that average IHT burdens are expected to increase by £34,000, after the changes are implemented in April 2027.

A spokesperson for the Treasury said: 'We continue to incentivise pensions savings for their intended purpose – of funding retirement instead of them being openly used as a vehicle to transfer wealth – and more than 90 % of estates each year will continue to pay no IHT after these and other proposed changes to IHT are fully adopted.'

However, for those financial planners and the 10% of clients that will do so, it will be vital to keep abreast of any developments in this fast-changing space over the coming months until these proposals come to fruition.

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