Insights

How the 2027 inheritance tax changes affect pension schemes and death benefits

John Wilson, Head of Pensions Technical | 06 Nov 2024

The proposed change to inheritance tax on pension death benefits will affect pension schemes, trustees, employers, and beneficiaries.

After months of speculation that Chancellor Rachel Reeves would make big changes to pensions taxation to shore up the public finances, Reeves only announced one significant measure affecting the pensions industry.

From April 2027, inheritance tax will apply to almost all unused pension pots and death benefits. At the moment, most inherited pensions are free of both inheritance tax and income tax if the member who dies is aged under 75.

The proposal reaches further than expected

Reeves's proposal initially looked like a matter mainly for financial advisers rather than pension schemes and administrators. But the government's consultation document reveals that the measure's ambit is wider (potentially, much wider) than it first appeared.

As well as the increase in the benefits in scope of inheritance tax, pension scheme administrators will be liable for reporting and paying inheritance tax due on unused pension funds and death benefits. They will do so based on information provided by the member's legal personal representative after using an HMRC calculator, and there are timescales for compliance.

The government is asking for views about how scheme administrators will meet the new requirements, including how to make sure the right information flows between HMRC, administrators, personal representatives, and beneficiaries.

There are many questions for pension schemes

This, however, is just one issue in a consultation with many considerations, including:

- Employers may need to review how they provide life assurance and death benefits to their employees.
- Pension scheme rules may need changing, subject where applicable to a consultation or trustee consent.
- Trustees and administrators may want to take the opportunity to remind members about their death benefits and nomination forms.
- Trustees should then tell administrators about changes to scheme design and check that scheme administrators can meet their new responsibilities.
- It's not clear whether life policies provided by employers, which are outside the consultation, will be exempt from inheritance tax.
- A death benefit could potentially be subject to inheritance and income tax.

Let's not increase the burden on dependants

Our overriding concern is that this change could make the already complex task of managing a deceased person's affairs more bureaucratic, prone to error, and stressful for dependants and beneficiaries.

Scheme administrators should take the time to respond to the consultation to make sure the government's policy intention is reflected in the legislation – and that the process is workable for the people who will administer the change and dependants dealing with an emotional situation.

At Aptia we will seek as much clarity as possible and press the case for a simple and effective framework that doesn't add to the overall administrative burden.

The good news from the budget remains that the government listened to the industry and rejected proposals to charge national insurance on employers' pension contributions or make changes to tax-free lump sums.

Compared with those potential measures, the change to inheritance tax is relatively minor. But, as ever with pensions, nothing is as simple as it seems.