

IHT on pensions - what we know so far

Synopsis: The proposed rules and process for applying IHT on most unused pension funds from 6 April 2027.

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In the October 2024 Budget, the Chancellor announced that, from 6 April 2027, most unused pensions funds would fall into the member's estate. The change would remove the current distinction between those death benefits paid under the discretion of the scheme and those that are not. Currently, where the scheme has discretion, the payments are generally free of inheritance tax (IHT) whereas, where there is no discretion, benefits will fall into the member's estate.

IHT will apply regardless of whether the member dies before or after they have reached the normal minimum pension age.

Importantly, the spousal/civil partner exemption still applies in the normal way and so any pension fund passing to a spouse or civil partner will normally be exempt. Dependant's scheme pensions are out of scope. These are generally paid from defined benefit schemes and can be paid both before and after the member has taken benefits from the scheme.

A technical consultation was issued at the same time as the October 2024 Budget announcement and, as well as providing high level details of the scope, it focussed on how the new rules will be implemented. The initial proposal was that pension schemes would be responsible for reporting and paying the IHT due on the pension funds.

The consultation response was published on 21 July 2025. Following overwhelming feedback from the pensions industry the Government outlined a fundamental change in the process and clarified and amended some aspects of the scope.

The revised (proposed) process

From 6 April 2027, personal representatives (PRs) will be liable for the reporting and payment of IHT due on unused pension funds and death benefits.

Pension beneficiaries will become jointly and severally liable for any IHT due on unused pension funds and death benefits to which they are entitled from the point at which they become entitled.

Pension schemes will be required to make the liability position clear and explain to non-exempt beneficiaries (i.e. beneficiaries not covered by the spousal/civil partnership exemption) that IHT may be due on the pension when informing them about their benefits, how they can access them and options for paying IHT.

Broadly, there will be three options for paying the IHT charge due on pension funds...

1. Beneficiary elects the scheme to pay the charge

A beneficiary can direct that the scheme pays the IHT charge where the charge due on the pension benefits is £4,000 or more. Where the charge is less than this, the scheme may choose to allow the beneficiary to direct them to pay the IHT on a voluntary basis.

2. Beneficiary pays the funds directly

Where the beneficiary pays income tax on any pension funds they withdraw to pay the IHT, they can reclaim the income tax paid on withdrawals of up to the value of the IHT due. This is to ensure that the funds are not subject to both IHT and income tax and, generally, will apply where the member dies aged 75 or over or where lump sum payments exceed the member's lump sum and death benefit allowance.

3. The PRs pay the IHT due

Where the beneficiaries under the wider estate and the pension are the same then this should be fairly straightforward. Where they differ, the PRs will need to reclaim the IHT paid from the beneficiary of the pension fund.

The revised process will require PRs and pension scheme administrators to work together in a timely manner. Where the scheme has discretion, they will have a much shorter timeframe than under the current rules to decide who should benefit. The key will be to promptly establish whether the beneficiary will be exempt (i.e. a spouse or civil partner) or not.

Scope

1. Death in service benefits

The consultation outcome confirmed that death in service payments paid from a pension scheme will not be in scope for IHT. This improves the current position for benefits where discretion is not applied, for example, such as the death in service payments paid from the NHS scheme.

2. Business property relief/agricultural property relief

The draft legislation introduces a new clause which specifically prevents pensions from benefiting from either of these reliefs where the underlying investments otherwise would – i.e. investing in them with pension funds doesn't achieve anything for IHT purposes.

3. Continuing payments under an annuity

Continuing dependant/beneficiary annuity payments under a pension annuity are out of scope. However, any unused guaranteed payment from an annuity will be included in the IHT calculations.

The Government state they will produce further legislation and guidance in due course. HMRC are working through the various issues with the pension industry, with workshops being held throughout September 2025 and no doubt further into the Autumn.

HMRC plan to introduce a calculator to allow PRs calculate the liability due on the pension funds.

The use of trusts

Payments into trusts from pensions are usually lump sum death benefits. As such, they do not escape IHT on first death (unless a death in service payment as explained above).

However, a payment into a discretionary trust will ensure the funds are outside of any individual's estate for IHT purposes on second death. Therefore, they will remain a useful planning option for death benefits both before and after the new changes take effect.

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