

Pensions and IHT from 6 April 2027 - interaction with other IHT allowances and reliefs

Synopsis: Once most pension funds will fall into the estate from 6 April 2027, how they will interact with other IHT allowances and reliefs.

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From 6 April 2027 most unused pension funds will fall into the estate for inheritance tax purposes.

HMRC's recent [technical note](#) also aimed to clarify how pensions will interact with other IHT allowance and reliefs.

Business Property Relief and Agricultural Property Relief

HMRC's note confirms that any investments held within a pension cannot be either "relevant business property" or "agricultural property". This is because the member is not treated as owning the pension assets personally. Therefore, there is no option to invest in assets that would otherwise qualify for these exemptions and reduce the amount of the pension fund that is subject to IHT.

Lifetime transfers and normal expenditure out of income exemption

HMRC state that they have been asked to confirm whether the exemption for normal expenditure out of income can apply to lifetime transfers made from funds withdrawn from a pension. We are aware that many providers and advisers have sought to seek clarification on this, particularly in relation to the use of tax-free cash. Using this exemption is one of the key ways to attempt to remove any pension assets from the estate for those wishing to do so.

In response to this, HMRC have merely confirmed that there have been no changes to the rules and that whether the exemption will apply will relate to the facts of each individual case.

Whilst HMRC's decision not to provide any specific answers is frustrating, it could also be seen that, if they had any concerns, this would be an opportunity to raise them.

Our view, therefore, remains that, where the income and/or tax-free cash is withdrawn regularly, (and it must be regularly) and all the other conditions are met, the exemption should apply. However, when advising clients, it should be made clear to them that the rules do not specifically allow or deny relief using these income streams.

Quick succession relief

Quick succession relief is designed to reduce the IHT payable where an estate includes assets received in the previous five years that were also subject to IHT.

HMRC confirm there are no changes to the existing processes or rules for quick succession relief. Where pension property, which has already been subject to IHT, is subject to IHT again within five years, quick succession relief will apply.

Leaving funds to charities

Where at least 10% of a person's net estate is left to a UK charity, their estate is taxed at a reduced rate of 36%, instead of 40%. For these purposes, the estate is split into three components: survivorship, settled property, and general. Each component is considered separately in determining whether any or all of them qualify for the reduced rate. It is possible for one component to meet the charitable giving conditions and be subject to tax at 36%, whilst the other components do not and remain taxable at 40%.

Pensions will form part of the general component for the purposes of the reduced rate of IHT and will be treated like any other property passing on death, and so the 36% rate can apply. Although, of course, the inclusion of pensions in an individual's estate will mean that a larger amount has to be left to UK charities to reach the required 10% figure than would otherwise have been the case.

A charity lump sum death benefit paid from a pension will count towards the amount donated to a qualifying charity from the general component, as will any non-excluded death benefits paid to a charity as a beneficiary, either nominated by the deceased or following the discretionary process.

Loss on sale

HMRC's technical note confirms that loss on sale relief is not available to pension assets. The member is not treated as owning the pension's assets, so loss on sale relief is not applicable to pension property.

Instalments

HMRC also confirm that the option to pay the IHT due in equal instalments over ten years is not available to pension assets.

Residence nil rate band

Whilst not covered in HMRC's technical note, it is worth noting that the value of the pension fund will be included in the total value of the estate when calculating the eligibility for the residence nil rate band.

Where the estate is worth more than £2m, the residence nil rate band will taper away. The residence nil rate band tapers by £1 for every £2 that the estate value exceeds £2m.

Including the value of pension funds will of course mean that, from 6 April 2027, many more clients will now lose part or all of the entitlement to the residence nil rate band.

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