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22 January 2025

Dear Ms O'Donoghue and Ms Rourke

Technical consultation - Inheritance Tax on pensions: liability, reporting and payment

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the technical consultation on Inheritance Tax on pensions: liability, reporting and payment, published on 30 October 2024.

The ACA welcomes the opportunity to provide input. Members of the ACA are all qualified actuaries – mainly Fellows of the Institute and Faculty of Actuaries. All actuarial advice given by our members is subject to the Actuaries' Code. Members provide advice to thousands of private sector, local government and public sector employers. The associated pension schemes provide defined benefit (DB), defined contribution (DC), cash balance (CB) and collective defined contribution (CDC) rights, with total assets of DB private sector schemes alone exceeding £1 trillion. We are therefore responding in the capacity of a representative body for professional advisors who provide advice to a range of occupational pension schemes.

We have two main concerns regarding these proposals: the impact on beneficiaries and the timescales, which arise because pension schemes benefits differ from other assets:

1. For decades, pension schemes have been designed not only to support members in retirement, but also their financial dependants following their death. We have serious concerns over the prospective worsening of provisions for financial dependants, including minor children. There need to be clearer and better exemptions and processes for financial dependants (i.e. where it is clearly a benefit meeting needs rather than any IHT avoidance planning).
2. Many private sector employers provide pension provision under trust-based occupational pension schemes. Commonly, the trustees decide who the beneficiaries are. The six-month deadline for paying the correct amount of inheritance tax (IHT) is unrealistic and too short, especially for complex family situations. In such cases, trustees of pension schemes need more time to perform their duties (which can be challenged in court).
3. Members often lose track of their pension benefits on leaving employment. Pension schemes often discover a member's death through their own tracing service, not by being alerted by Personal Representatives (PRs). Although this can be true of other types of assets, these benefits can be substantial - employees often don't realise the true worth of their benefits. This means that pension schemes may not find out about the death for some months, and may be unable to trace PRs, if they even exist - pension assets are often an individual's largest asset (aside, perhaps, from their house) so there may have been no reason to appoint PRs for the rest of the estate.

Further, we are concerned that pension schemes would be subject to deadlines, and potential penalties, although they would be reliant on external parties to notify the scheme in good time and with relevant detail.

PSAs also need to be able to pay out small pension pots without disproportionate administration or a concern that they might later be liable for any IHT due.

Appendix 1 of our response addresses the questions raised in the consultation. In particular, please see 'scope' under Question 3 which sets out some ideas to address the risk of financial hardship.

Appendix 2 considers other approaches whilst still integrating the IHT and pensions regime.

Appendix 3 builds on our argument that pension assets are fundamentally different. Instead of integrating the IHT and pensions regime, it proposes a separate Pension Inheritance Tax (PIHT). This would address our concerns regarding financial hardship and timescales. A simpler system would help HMRC, PRs, beneficiaries, financial advisers and PSAs as issues with IHT would not impact pension schemes and vice versa.

Appendix 4 includes some key definitions, including that of 'dependant'. Please note that where we refer to a dependant in our response we mean this definition which does not (usually) cover adult children.

We welcome that the Government has provided more time for implementation of these changes than other recent measures and we would be happy to discuss this matter further. Please contact Kirsty Cotton on 01737 274496 or Kirsty.cotton@wtwco.com, or Tim Sexton on 07841 494194 or tim.sexton@vialto.com. For discussion of the issues for smaller schemes, please contact Nigel Sloam on 020 8209 1222 or nigel@nigelsloam.co.uk

Yours sincerely

Kirsty Cotton FIA — Chair of the Pensions Taxation Committee

Tim Sexton FIA, — Vice-chair of the Pensions Taxation Committee

On behalf of the Association of Consulting Actuaries Limited

About the Association of Consulting Actuaries

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. Members also advise local government pension schemes, public sector employers, defined contribution schemes and individuals (many in self-employment) as well as advising life and general insurers.

Particularly relevant for this consultation, our members' work includes general consulting to enable the proper running of pension schemes from the perspective of sponsoring employers and trustees. Several of our members' firms also provide third party administration for pension schemes and so are key agents for the trustees running schemes. We are therefore also concerned that the proposals work for pension administrators.

Appendix 1: Responses to consultation questions

Consultation questions

Question 1: Do you agree that PSAs should only be required to report unused pension funds or death benefits of scheme members to HMRC when there is an Inheritance Tax liability on those funds or death benefits?

Question 6 considers reporting where the PR or HMRC realises that an amendment is needed after Inheritance Tax has been paid, so we have not considered that here.

In this question, we have considered reports required before, or alongside, the first IHT payment.

The consultation response description of the process includes "PSAs uses the Accounting for Tax return to report details of the member/estate, the Inheritance Tax due and the date of death"

Benefits and IHT due can be determined in time to report and pay the IHT by the due date

If the benefits and IHT due can be determined in time to report and pay the IHT by the due date of 6 months from the end of the month of death, then reporting only where there is an IHT liability would be appropriate.

However, PSAs would depend on the PRs of the deceased to confirm whether or not unused funds or a death benefit was in an estate that was liable to IHT, with the associated reporting and tax obligation. The PSA would have no knowledge of the rest of the deceased's estate. This potentially puts the PSA in an intolerable position of being liable for tax and penalties in respect of matters that are outside the PSA's knowledge and control. A good faith discharge would be required.

Benefits and IHT due cannot be determined in time to report and pay the IHT by the due date

PSAs might wish to pay IHT in advance to avoid late payment penalties. If so, then they would need to be able to report in advance of knowing whether IHT arises and so the above report would not suffice. More detail is provided in Question 2.

No PR can be identified

As set out in Question 3, one option if no PR can be identified is for the PSA to pay the benefit gross. If so, then HMRC would need to consider whether they wished to receive reports on all such payments, many of which might be very small, or operate a filter.

When the lifetime allowance (**"LTA"**) was in force, there was a tried and tested reporting of significant death benefits to HMRC. The PSA automatically reported to HMRC when the scheme made a lump sum death benefit payment to a person in respect of the death of a member if that payment, either alone or when aggregated with other such payments from that scheme, amounted to more than 50% of the standard LTA applicable at the time of the member's death[1]. (The threshold was approximately £500,000.) The PSA reported the name and national insurance number of the deceased member, together with the name and national insurance number of the person to whom the payment was made, and the amount and date of the payment.

This worked well and was easily understood and applied by PSAs, and it also provided good reporting of information to HMRC.

A simple monetary limit, i.e. reporting lump sum death benefits above a certain threshold, perhaps half of the nil rate band, would be simple to operate and quicker than waiting to establish PRs.

Question 2: How are PSAs likely to respond if they have not received all the relevant information from the PR to pay any Inheritance Tax due on a pension by the 6-month payment deadline?

In our response to this question we have considered options if the PRs have not provided all relevant information. Why there might be delays is covered under Question 7.

Invidious options for the pension scheme trustees

We see potentially five main options for the trustees, but all have significant problems, and none appears to us to be satisfactory.

(a) Distribute the benefits to some or all of the beneficiaries early and risk an unbudgeted IHT charge
(b) Do nothing, i.e. do not provide any benefits until the PRs have provided all the relevant information
(c) Pay HMRC 40% of the benefit as an on-account payment of IHT and then pay benefits to the beneficiaries from the remaining 60% of the benefit
(d) Hold back 40% of the benefit in case of a potential IHT charge, and then pay benefits to the beneficiaries from the remaining 60% of the benefit
(e) Consider all of the above options on a case-by-case basis

(a) Distribute the benefits to the beneficiaries as now and risk an unbudgeted IHT charge

This is not a viable option for the trustees since the PSA would remain liable for any IHT even after distributing the benefits. It would not be acting as a prudent trustee should act.

(b) Do not provide any benefits, and wait for the PR to provide all the relevant information

The trustees have a fiduciary responsibility to distribute the benefits that have fallen due. The principal beneficiary to be considered may well be a financial dependant and might face financial

[1] The Registered Pension Schemes (Provision of Information) Regulations 2006, SI 2006/567, regulation 3(1) (Provision of information by scheme administrator to the Commissioners), Item 2. Repealed with effect for the tax year 2024–25 and subsequent tax years: Finance Act 2024, s 14, Sch 9, Pt 5, para 106(2)(a)

hardship if the trustees delay making distributions. If they are not a legal spouse/civil partner, they would not be entitled to any spousal exemption[2]. A key advantage of pension scheme death benefits is that they sit outside the deceased's estate and so can allow interim funds to be distributed swiftly to any dependants who might face financial hardship if they had to wait for probate to be granted.

Waiting for the PRs to provide information also risks the death benefits being distributed more than two years after the trustees became aware of the death. For deaths before age 75, this often changes the income tax treatment of the death benefits, to the significant detriment of the beneficiaries, and the trustees have a fiduciary duty to act in the beneficiaries' best interests.

Furthermore, if the trustees make a conscious decision not to distribute benefits, despite a requirement under the scheme's trust deed and rules to do so, then the trustees risk adverse rulings against them by The Pensions Ombudsman and/or the Courts who have the power to direct the trustees to take steps or refrain from taking prescribed certain steps[3].

This approach would also put huge pressure on those doing the day-to-day administration who would need to explain to desperate beneficiaries why they couldn't receive the money that was rightfully theirs.

(c) Pay HMRC 40% of the benefit as an on-account payment of IHT and then pay benefits to the beneficiaries from the remaining 60% of the benefit

An on-account payment of contingent IHT would create significant administration and practical problems for both HMRC and the PSA.

- The PSA would need an IHT payment reference number. Would this be possible? The consultation proposes (2.26) that the PRs notify the PSA of this number, but in this case the PRs would not yet have obtained a number.
- How much in advance of the intended date of payment would the PSA need to apply for a reference number?
- HMRC's systems might potentially get multiple requests from different pension schemes, none of whom would be the PR managing the estate, relating to the same estate.
- It would often create overpayments of IHT that would then require administration by HMRC to process refunds to the correct pension scheme. It would at least double the administrative burden on HMRC, and potentially on the PSA as well. It would be challenging to justify this approach where the ultimate beneficiaries would benefit from the spousal exemption. Over-deducting is not in the interest of beneficiaries – and is likely to result in

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[2] Section 18 of the Inheritance Tax Act 1984. In addition, not all spouses/civil partners are entitled to the IHT spousal exemption.

[3] By April 2027, it is expected that any determination or direction of the Pensions Ombudsman will be enforceable as if it were a judgment or order of that court. See King's Speech Background Notes. Currently, this needs a court order under Section 151 of the Pension Schemes Act 1993

negative press comment and problems for recipients similar to those where the emergency tax code is used for one-off pension lump sum withdrawals.

- The interest rate on refunds might be lower than the return that would have been achieved on scheme assets – so where IHT has been overpaid, beneficiaries would have been better off if the PSAs had not paid the IHT.
- In some instances, such as when there is no PR, the PSA would not know and would not be able to know when the PRs had completed the IHT affairs of the estate, and so would not know if or when to seek a refund of excess IHT.
- Pension schemes have controls in place to prevent two lump sum payments to the same individual – this is designed to prevent error. A second payment is likely to require senior authorisation, adding administrative costs, which for DC schemes are likely to reduce members benefits.
- It might be impractical where a dependants' annuity is to be purchased as providers impose limits on the minimum that can be secured.

Communicating the benefits to bereaved beneficiaries, and explaining how and why there was contingent tax, would be complicated and fraught. Since the default position would be to withhold the tax, on a contingent basis, in all cases, there is a risk that it would be seen by the beneficiaries and the public as a death tax extracted by HMRC on all death cases. Further, in the majority of cases where HMRC expects no IHT to be payable, the issues identified in b) above would apply to the 40% of IHT paid to HMRC.

(d) Hold back 40% of the benefit in case of an IHT charge, and then pay benefits to the beneficiaries from the remaining 60% of the benefit

This approach would address some of the disadvantages of making on-account payments of 40% IHT on a contingent basis. It would not address the fact that in the majority of cases HMRC expects no IHT to be payable and so the issues identified in b) above would still apply to the 40% withheld.

Further, the trustees would then be exposed to a different but even less acceptable problem.

HMRC charges interest on IHT not paid by the end of the calendar month six months after the calendar month in which the person died. Following the Autumn Budget 2024[4], by April 2027

[4] The late payment rate will be increased by 1.5% from 6 April 2025. Para 5.27. https://assets.publishing.service.gov.uk/media/672b9695fbd69e1861921c63/Autumn_Budget_2024_Accessible.pdf

interest on late paid tax will be charged at base rate plus 4%[5]. On current base rates of 4.75%, this would mean an interest rate on late tax of 8.75%.

The interest rate on late tax may be higher than the trustees would expect to earn on the assets in the pension scheme. The Financial Reporting Council is the statutory body responsible for the technical actuarial guidance[6] on statutory illustrations of money purchase benefits. This guidance asks the trustees of a money purchase scheme to classify their proposed assets into four groups, from least volatile lowest expected return assets to most volatile highest expected return seeking assets. Currently, even the highest expected returns that the trustees may use to project expected money purchase benefits is 7% per annum, significantly below the interest rate charged by HMRC.

It puts the trustees in an invidious position to have a potential IHT bill that they cannot quantify (because this can only be done by the PRs who have knowledge of the estate as a whole) and where they cannot control all parts of the process. The interest on late payment runs at a rate significantly above even the most optimistic rate that the Financial Reporting Council would tolerate the trustees assuming on statutory money purchase projections.

If the late payment interest exceeds the actual return on scheme assets, and the IHT due approached the full 40%, then other members' benefits would have to be reduced to cover HMRC's late payment interest – given that the remaining 60% would already have been paid out. This would make this option unviable since it would not be acting as a prudent trustee should act.

Again, this approach might be impractical where a dependants' annuity is to be purchased as providers impose limits on the minimum that can be secured.

(e) Case by case

This approach incorporates the complexities of all the above options, together with additional administration for the trustees. It probably brings the worst of all worlds.

Question 3: What action, if any, could government take to ensure that PSAs can fulfil their Inheritance Tax liabilities before the Inheritance Tax payment deadline while also meeting their separate obligations to beneficiaries?

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[5] The rate of interest that HMRC currently charges on late tax is set at 2.5% above the Bank's base rate. https://www.gov.uk/government/publications/rates-and-allowances-hmrc-interest-rates-for-late-and-early-payments/rates-and-allowances-hmrc-interest-rates

[6] Consultation on AS TM1 v5.1 (November 2024) https://www.frc.org.uk/consultations/consultation-on-as-tm1-v51-november-2024/

Our answer to this question assumes that there would not be a change to the standard IHT deadlines.

Scope

The first action that the government could take would be to reconsider the scope of the benefits that would fall outside IHT so that these could be paid as now with no interaction with PRs.

Dependants' scheme pensions

We welcome and support the proposal that dependants' scheme pensions would not be included within scope of IHT. This will enable pension scheme trustees to commence speedy payments of these benefits without undergoing any more checks than are currently required. With many families impacted by cost of living pressures, it is important that an income stream can commence as soon as possible to avoid debts building up.

Dependants' annuities

We would like HMRC to go further and also exclude dependants' annuities from the scope of IHT. The principle is the same as for dependants' scheme pensions: the entire benefit is immediately put into payment as an income for life. For deaths after age 75, these payments are fully subject to income tax and PAYE in the normal way. These annuities are currently non-taxable for death before age 75 provided that entitlement to the dependants annuity arose within the relevant two years period. Given people don't generally 'plan' to die before age 75, there isn't usually scope to use a dependant's annuity as an IHT tax-avoidance device.

Including dependants' annuities would remove one difference between the treatment of defined benefit (DB)/collective defined contribution (CDC) arrangements (where a survivor pension is always a dependants' scheme pension) and defined contribution (DC)/cash balance (CB) (where a survivor annuity can be classified as either a dependants' scheme pension or a dependants annuity, depending on how it is secured.)

We expect that the Government didn't intend to extend IHT to reversionary annuities purchased alongside an individual's pension prior to death. If that is not the case, then HMRC would need to consult with the industry on the complicated issues that would arise.

It is permitted to continue payment of a deceased member's scheme pension or annuity for up to ten years from entitlement – with those payments being made to any person. The IHT treatment of these continued payments if paid to a dependant should mirror that as if the payment was a dependants' scheme pension or dependants' annuity.

Dependants' drawdown pension

A level or inflation linked pension for life is not always the most appropriate way to provide for financial needs. For example, an individual might wish to earmark pension resources for the possibility that they will need to pay for care in later life. As such, we suggest that amounts allocated to dependants' drawdown should also fall outside IHT, but subject to the caveat that the definition of dependant for drawdown is currently wider than the usual definition and includes children aged 23 or over who are not dependant on the member because of physical or mental impairment. The ACA is not arguing that amounts designated to drawdown in respect of such a child should fall outside IHT.

For deaths after age 75, these payments are fully subject to income tax and PAYE in the normal way. Amounts designated to drawdown are currently non-taxable for death before age 75 provided that entitlement to the drawdown pension arose within the relevant two years period. This is a more generous tax treatment than applies to dependants' scheme pensions. However, as noted above, individuals don't usually 'plan' to die before age 75, so the scope for abuse is limited.

Emergency payment and funeral benefits

PSAs should be permitted to pay a small lump sum gross without needing to interact with PRs. The maximum could apply per scheme (or per beneficiary under the scheme). If HMRC were concerned about the risk of abuse of this easement by fragmentation, such amounts could be treated as part of the estate (perhaps as payments made in advance of any other post-death distributions). In some cases, this would mean that IHT was due (and might be settled in the same way as IHT on non-exempt gifts made before death.)

The limit on these payments should be at least £10,000 (the amount that can be commuted for a small lump sum).

Some beneficiaries of pensioners can be paid a 'life cover lump sum'[7]. This is a tax-free lump sum payable on death after 75 of pensioners who had a right to that benefit on 5 April 2006. It is often limited to £2,500. Typically, this benefit was to provide a sum to cover funeral costs and so needs to be paid speedily. Given the small and dwindling number of individuals entitled to this benefit, we propose that legislation prescribes that it is exempt from IHT and so can always be paid with no interaction with PRs.

Small pots

As is well documented[8], there are millions of small pots. Measures under the Pension Schemes Bill[9] will take steps to address this, but this will not solve the issue. The proposed process would impose disproportionate costs in relation to these small pots. We propose that PSAs should be permitted to

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[7] This is described in https://webarchive.nationalarchives.gov.uk/ukgwa/20240305095441/https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm074000 and provided for under SI2006/572 Reg 6

[8] For example, Ending the proliferation of deferred small pots, Consultation outcome, 22 November 2023. https://www.gov.uk/government/consultations/ending-the-proliferation-of-deferred-small-pension-pots/ending-the-proliferation-of-deferred-small-pots "The data responses to the call for evidence cover roughly 20 million deferred pots worth less than £10,000,…"

[9] See King's Speech Background Notes.

pay small pots which extinguish a beneficiary's rights under the scheme gross without needing to interact with PRs. The same limit and process should apply for these small pots as for emergency distributions discussed above.

Life cover

We expect that that the Government didn't intend to extend IHT to life cover provided under a pension scheme. We support that intention.

This exemption should apply regardless of whether or not a PSA chooses to take out insurance to cover the benefit. Further, it should cover both lump sum and pensions payable on death. These are not benefits of the member as the member cannot access them – they only arise on the member's death.

We note that some members might use the life cover provided by the pension scheme as an alternative to taking out life cover to pay off an outstanding mortgage. If we are incorrect, and this life cover would be in scope of IHT, then individuals would need notice of this change – IHT due on such life cover could easily be several £100,000 and insurers often a limit how quickly an individual can change their level of life cover within schemes.

Process

In order to fulfil their IHT liabilities before the standard IHT payment deadline, PSAs will, as a minimum, need:

To be informed of the death of the scheme member promptly, to have sufficient time to complete various steps and processes.

The PSA is likely to be informed of the death of an active member of an occupational pension scheme, and may be informed of the death of a pensioner member in receipt of a **regular income**. However, the PSA will often not know about the death of a deferred member or a retired member who only intermittently takes income drawdown from the pension scheme. It is not uncommon for deaths to be first reported to PSAs, or for PSAs to discover the death themselves through tracing exercises, only several years after the person had died.

The government could legislate to require the PRs to inform the PSA promptly and to provide accurate information promptly, but this will not ensure that these actions happen, not least because PRs might find it difficult to track down pension assets. Where PRs are also beneficiaries they will be incentivized to get in touch in order to be able to receive benefits.

In order to speed up the process, a minority of pension scheme trustees may want to replace their power to choose beneficiaries with a mandatory decision based on scheme rules and/or a nomination form. We suggest that the Government considers whether an overriding power might be helpful to enable trustees who wanted to make this change to do so.

There would be winners and losers – the losers are most likely to include hard-pressed financial dependants where no Will has been made. We expect that most pension scheme trustees would want to retain discretion so that they can take the needs and interests of all potential beneficiaries into account – to deal with unusual family situations as well as the frequent position where members' nomination forms are out-of-date (noting that many deferred members do not engage with their occupational pension scheme between leaving the relevant employment and retirement, a period that can run for decades). As noted in question 7, this is likely to mean that the timeline cannot be met in some cases.

To be able to identify benefits that fall within the spousal exemption

In most cases, benefits payable to a surviving spouse or civil partner would not be subject to IHT. However, under current legislation, an exception is where the survivor is neither domiciled nor deemed domiciled in the United Kingdom. The current Finance Bill proposes to replace domicile in IHT with the concept of long-term resident. A process would need to be established so that PSAs can quickly and accurately confirm whether a survivor is impacted by the domicile/residency issue and, where they are not, pay benefits to surviving spouses and civil partners in line with their current process without waiting for further information from PRs.

The number of widows, widowers and civil partners who would understand the tax aspects of sections 6A and 6B[10] of the Inheritance Tax Act 1984 concerning long-term residence for IHT purposes, and its interaction with section 18 of IHTA 1984 concerning inter-spousal transfers is likely to be very small. A bereavement is a difficult time for a family and pensions administrative matters have to be handled sensitively. Detailed complex questions to a bereaved widow(er) concerning the deceased's tax status and the bereaved's own tax status under complex parts of IHTA 1984 will be practically problematic.

To be put in contact with the PRs promptly.

Even where the PSA has identified that a scheme member has died, there is often no way for the PSA to find out who the PRs are – and for small estates there is often no PR. For example, the PSA might use a mortality screening service and identify from this that a member has died, but would have no contact information to progress the case.

As noted in the consultation, tax-free lump sum death benefits become subject to income tax if not paid within two years from the date that the PSAs were aware of the death or should have been aware. It would be helpful it this deadline could be extended to the later of two years and six weeks after notification has been received from the PR either that no IHT is payable or of the nil rate band that applies.

Where the PSAs have been unable to identify the PR within a period, then one approach would be for the PSA to pay the benefit gross (at least up to the single or joint nil rate band) with a reporting requirement to HMRC. HMRC would then collate information on all such benefits, and levy IHT on the beneficiaries where appropriate.

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[10] To be inserted by the current Finance Bill.

To be able to value the death benefits promptly and accurately.

Sometimes valuing the death benefits would be easy, but in other cases, for example:

- if the scheme assets include illiquid assets there would be delays in obtaining valuations.
    - We understand that a RICS valuation is required for any properties. That alone can often take more than 6 months. Then the trustees need to agree how the funds will be raised. This will either be by remortgaging them or by selling them. Properties are commercial properties, so that can be a further year.
    - The valuation can be controversial where there is more than one member of the trust – the valuation of the asset, and the consequent IHT charge, will result in a real one-off reduction to the pension schemes' assets which will reduce the amount available to other members of that trust.
    - We note the Treasury's Mansion House initiative to increase the proportion of assets of pension schemes in less liquid long-term unquoted investments, patient capital or long-term infrastructure. These are likely to be harder and slower to value.
- we expect that that the Government didn't intend to extend IHT to reversionary annuities, but if it did, then guidance would be needed to value these.

The PRs to be swift, accurate, competent and efficient in supplying the detailed technical information needed for the PSA to identify potential IHT charges.

The PSA will be entirely dependent on the PRs to provide the relevant information on a timely basis. If this does not happen then the PSA ends up with a tax liability and interest on late payment of tax (and a risk of penalties) for matters entirely outside the PSA's control.

There are two late payment penalties that might apply.

The first are fines for failing to file certain documents on time. PSAs would want reassurance that the 'Reasonable excuse'[11] provisions would apply so that penalties do not arise.

The second is late payment interest. Please see Question 9 for alternatives.

To have sufficient funds to be able to pay the IHT

Flexible payment

For smaller schemes, similar issues can arise as for individuals. Specifically, it will be challenging to disinvest to meet the IHT where a large proportion of the assets are held in illiquid investments – most likely to be an issue for smaller schemes, but perhaps also for larger schemes if the Government is successful in encouraging more investment in illiquid assets. Schemes should have

[11] https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm36061

similar options to estates for individuals including permission for a 10-year schedule of payment of the IHT liability.

In smaller schemes where there are several members with assets held under a common trust, forced sales of assets at short notice will disadvantage both financial dependants and continuing members.

Market crashes

In the event of asset values falling between the date of death and the date the paperwork is completed to enable payment, so that the pension scheme no longer had sufficient relevant assets to meet the IHT charge, the excess charge should fall on the estate. In those circumstances, no payment would be made to the beneficiaries from the pension scheme. It would be iniquitous to expect other members of the scheme to meet an IHT charge.

Question 4. Do you have any views on PSAs reporting and paying Inheritance Tax and late payment interest charges via the Accounting for Tax return?

Yes.

The consultation states "HMRC will raise a charge for the IHT with a due date of 6 months from the end of the month of death". Since, as noted above, the PSA is often not notified of members' deaths on a timely basis and may have to wait for the PRs to get in touch (the scheme would not necessarily know the identity of the PRs to initiate this), there are likely to be many cases where any IHT could only be first paid more than 6 months from the end of the month of death.

(a) The Accounting for Tax ("**AFT**") return is compiled and submitted quarterly. IHT falls due monthly. For example, if IHT falls due in July (based on a death in the previous January) this would be covered by the July to September AFT return that would be submitted and paid by 14 November. If IHT was paid via an AFT return for the calendar quarter in which the IHT fell due, e.g. by 14 November for IHT falling due in July, would this be regarded as a timely payment with no late payment interest? Alternatively, if the IHT had to be paid with an AFT filed before 31 July in order to be paid on time, then this would require the pension scheme to process any IHT payment before 31 March, to come within the AFT return for the January to March period. That might require the whole process from reporting the death, through to the exchange of information, calculating the estate and processing the IHT due, to be completed within 2 months of the date of death, and would be impractical.

(b) Once it is accepted that the due date for payment of IHT by a pension scheme administrator has to be different from the due date for payment of IHT by a PR, since AFT submission dates are never month end dates, we strongly recommend using a regime that is designed to reflect how pension schemes operate in practice. The most sensible structure would be to align IHT with the way Annual Allowance and other tax charges are reported through the AFT, being due with the AFT in which the relevant taxable payment was made. As such, the IHT would fall due in the AFT compiled in respect of the calendar quarter in which the death benefit, e.g. a lump sum, was made or paid to the beneficiaries. So, in the example above, if the death benefit was paid on 3 July, it would be covered by the July to September AFT return that would be submitted and paid by 14 November. In any scheme, a large IHT charge could have an impact on cashflow (hence needing some notice of the charge), but in a small scheme with a high proportion of illiquid assets it might be impractical to pay the IHT charge on time. As already noted, PSAs will need to be able to access the same flexibility for paying the IHT as is available to PRs.

The amount due (including late payment charges) should be deductible from the benefits for those beneficiaries to which the IHT relates and this specifically needs to be legislated for as a charge a pension scheme can make and deduct from the death benefits.

Question 5. Do you agree that 12 months after end of the month in which the member died is the appropriate point for their beneficiaries to become jointly and severally liable for the payment of Inheritance Tax?

No.

This question asks about the process to follow after PSAs have reported and paid any IHT to HMRC, but an amendment to the IHT due is required, for example because the PRs discover further assets. Once the scheme has paid the relevant funds to the beneficiaries, then any additional IHT should be the sole responsibility of those beneficiaries. For example, if some of the funds were paid to the spouse (and benefitted from the spousal exemption) and others to the children, only the children should be pursued for the additional tax.

There should be an immediate good faith discharge for PSAs on distributing the benefits so that there is no further liability after paying out benefits. Relying on HMRC's discretion as to whom it chooses to pursue for the tax is a very weak protection for the trustees who should be taxed only by law and not left untaxed merely by discretion.

Once benefits have been distributed, the deceased member's record in the pension scheme would potentially have been closed. There are material barriers and complexity in re-opening a closed member record, especially of a deceased member, which are important financial controls to prevent fraudulent activity.

We note that reallocating IHT charges amongst pension schemes/the estate will result in extra income for HMRC because the late payment interest rate exceeds that on refunds[12] [13]. This seems unfair to beneficiaries.

Question 6: What is the most appropriate means of identifying or contacting beneficiaries if either the PR or HMRC realises that an amendment is needed after Inheritance Tax has been paid? Should PSAs be required to retain the details of beneficiaries for a certain period?

We suggest that the same process is adopted as applied for the LTA charge[14]. Where a LTA charge arose, PRs notified HMRC, who contacted the scheme for additional information regarding the beneficiaries.

We note that there has been a change in approach regarding information that can be provided in respect of the LSDBA. SI2006/567 Regulation 8 now requires PSAs to provide detailed beneficiary information to PRs on request. We think there are risks to this approach and it is safer to disclose the information to HMRC.

An alternative approach would be to report to HMRC on all payments in scope at the point they are paid. Given that HMRC estimates that fewer than 20%[15] of estates will have an IHT liability, we think it would be unnecessarily burdensome to require schemes to submit information to HMRC on all payments in scope at the point of payment.

Question 7: What are your views on the process and information sharing requirements set out above?

The flowchart does not reflect what generally happens in practice.

Important points of omission include:

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[12] The rate of interest that HMRC currently charges on late tax is set at 2.5% above the Bank's base rate. https://www.gov.uk/government/publications/rates-and-allowances-hmrc-interest-rates-for-late-and-early-payments/rates-and-allowances-hmrc-interest-rates

[13] The late payment rate will be increased by 1.5% from 6 April 2025. Para 5.27. https://assets.publishing.service.gov.uk/media/672b9695fbd69e1861921c63/Autumn_Budget_2024_Accessible.pdf

[14] https://webarchive.nationalarchives.gov.uk/ukgwa/20240305094932/https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm087000

[15] HMRC consultation “out of around 213,000 estates with inheritable pension wealth in 2027 to 2028 …. Around 38,500 estates will pay more Inheritance Tax than would previously have been the case.” 38,500 / 213,000 = 18%.

PSA discovers death

A PSA often learns about a death through their activities to check people are still alive, the bank notifying or a relative/friend getting in touch. In the latter case, they may not be PRs. PRs only come into the process, if at all, at a later stage. The PSA usually has no way of identifying who might be the PR and so could not initiate any contact.

Discretionary decisions

In a trust-based occupational pension scheme the trustees have the power to manage investments and almost always also have the power to choose how benefits on death are to be distributed.

For many schemes, the paperwork is not dealt with by the pension scheme trustees. It is the trustees who will make the decision regarding the benefit distribution etc. There is therefore usually an additional flow of information from the day-to-day administrators to the pension scheme trustees and back.

Where the pension scheme trustees have discretion as to the potential recipients, information about who these are – and their respective financial and other needs and resources will be required in order to make that decision. This will generally include information about the Will – so a request from the pension scheme trustees to the PRs and back. Other information will also be required, often directly from potential beneficiaries. This stage can take some time. As outlined earlier, we expect many trustees to be required and to wish to retain the option to have discretion to choose the beneficiaries (as is currently common in pension schemes.) The process needs to allow for sufficient time for good decisions to be made. Elsewhere, we have emphasised the need for speed, but that is not always the case - there is currently no effective deadline for a decision for deaths after age 75 – and in complex circumstances these decisions can take some years particularly in cases where the deceased has been divorced and subsequently repartnered.

Deciding how benefits should be distributed is sometimes time-consuming, for example if the deceased had beneficiaries from more than one relationship – e.g. if someone remarried. In smaller schemes, the expression of wishes form might be written as a principle e.g. "Sufficient to my spouse to keep my spouse in the manner to which s/he is accustomed, with the remainder to the children", which requires considerable information to assess.

Trustees must ascertain the position of potential beneficiaries as part of their duty. Trustees frequently receive legal advice to the effect that distributions should only be made once the quantum and provisions of the deceased's estate are known. Acting prior to this, could well lead to trustees acting in breach of duty.

If the deadline is too short, Trustees of pension schemes will in many cases be unable to perform their duties and may, in consequence, face action in the courts from aggrieved potential beneficiaries.

In some cases, the introduction of IHT will lead to a circular process. The member might wish for 50% to go to the spouse and 50% to their child. If the pension scheme trustees interpret the member's wishes as meaning that this split should ideally be post-IHT, then they will need information from the PR's to help determine an appropriate split. So, for example, if IHT is likely to be levied at approximately 30%, then they might provide 41% to the spouse and 59% to the child (with the child receiving 59% x (1-30%) = 41%.)

The position is further complicated where there are Court Orders regarding death benefits, following a divorce.

Valuation of assets

As noted in Question 3, the valuation of assets can be complex and controversial and may need information flows to an expert.

Spousal exemption

In our view, the PRs only need to know the total value of benefits payable and the split between the surviving spouse/civil partner (provided covered by the spousal exemption) and other beneficiaries. That is the only information that is required to determine the IHT liability.

PSAs will need assistance in determining whether or not the spousal exemption applies (depending on the process agreed here – See Question 3).

Emergency payments

The process does not recognise that many beneficiaries need money urgently and so pension scheme trustees seek to pay benefits as soon as possible. This issue was raised strongly in relation to the 6 April 2023 change from an LTA charge to an income tax charge – with HMRC agreeing to revert to the previous process whereby lump sum death benefits tested against the LTA would be paid gross by PSAs with HMRC levying any LTA charge on beneficiaries at a later date. This same process survives into the 6 April 2024 regime – benefits assessable against the LSDBA are paid gross with HMRC levying any income tax after the end of the tax year. The process as outlined is too slow for straightforward cases. (See question 3 under scope and question 9 for other approaches that would address this.)

Question 8: Are there any scenarios which would not fit neatly into the typical process outlined above? How might we address these?

Yes.

In addition to the points made under question 7, other problems include lost benefits, where the PSAs may not be alerted for some years. Aligning the date on which IHT would fall due to the AFT reporting period in which any benefits were paid would partially address this issue, as would not reallocating the nil rate band (see question 9 below).

We have not considered in detail whether there could be issues around valuation or payment in respect of schemes that are being assessed as candidates to enter the Pension Protection Fund. The value of benefits can be uncertain until the assessment has been completed. Again, aligning the date on which IHT would fall due to the AFT reporting period in which any benefits were paid would address this issue.

UK long-term residents might have worked overseas for a brief period and have accrued funds in an overseas pension scheme, but might die before retirement leaving the funds in the overseas pension scheme. We note that the current consultation is restricted only to UK registered pension schemes and so it is as yet wholly unclear how HMRC intends to impose a tax obligation on the scheme managers of qualifying non-UK pension schemes ("**QNUPS**").

Question 9: Do you have any other views on the proposal to make PSAs liable for reporting details of unused pension funds and death benefits directly to HMRC and paying any Inheritance Tax due on those benefits? Are there any feasible alternatives to this model?

We have addressed this question in Appendices 2 and 3.

Appendix 2 considers alternatives where pension benefits remain within the IHT regime.

Appendix 3 considers an alternative approach whereby a new "Pensions Inheritance Tax" is applied to pension scheme benefits instead of attempting to integrate pension schemes into the IHT regime.

Appendix 2: Consultation question 9: Other approaches pension schemes within IHT regime

Mitigating delays to payments

One of our main concerns is that PSAs can pay benefits speedily in cases of financial hardship.

Some suggestions to help with this were included under Scope under Question 3.

Other possibilities include

Exemption for Financial dependants

Under this approach, IHT would not be levied on financial dependants whether the payment was as income or a lump sum. This would enable payments to be made swiftly to those in financial hardship. Where all of the potential beneficiaries are financial dependants, this also means that the estate could be settled without needing any information from PSAs.

Minimum Age Exemption

The fact that those of working age are more likely to have minor children than older generations, and societal trends towards cohabitation rather than marriage mean that younger deaths are more likely to leave financial dependants who are not spouse/civil partners.

There could be an exemption for pension assets from IHT if the member dies before a certain age. We suggest State pension age as Government policy is that people should continue working until State pension age and not be drawing down their pension benefits.

However, this does not address financial hardship arising from deaths of older members, including financially dependent cohabitees, those dependant due to physical or mental impairment or minor children of later marriages.

IHT always met by the estate

The PSAs could always pay 40% to the estate (for the PRs to pay any IHT and allocate any excess according to the Will.) This would mean that the pension schemes could carry on with their current processes – but only in relation to the net 60%.

We expect that this would often slow down total payments – we understand that the Estate can't make a payment until at least some of the IHT is paid and probate granted, whilst pension schemes should be able to make a payment at an earlier stage. HMRC figures suggest that no IHT will be due in the majority of cases.

In some of those cases there will be no need to appoint PRs. In those cases, how will it be determined that no IHT is payable so that the remaining 40% can be released?

Both delays in payment and the deduction are likely to lead to complaints.

It would also be unpopular where assets could otherwise have been kept within the tax-favoured pension environment.

This process would mean that up to 40% of the assets could not be distributed under discretionary powers. There will be winners and losers – with losers likely to include those where the individual died with no will and the potential beneficiary is not included under the standard intestacy allocation.

IHT always met by beneficiaries

A similar process could be used for IHT as applies for the LSDBA (and before that the LTA). In outline:

- Benefits are paid without deduction of IHT by PSAs
    - If IHT is due on the amount before assessment to income tax, PSAs would need instructions as to how to calculate PAYE where income tax is due.
- PSAs report certain information to PRs
- PSAs could also be required to report larger benefit distributions to HMRC to ensure that these don't escape IHT
- PRs assess whether or not there is an IHT charge and the amount that falls on pension schemes assets
- PRs report to HMRC
- HMRC follows up with PSAs if they need further information on beneficiaries
- HMRC follows up with beneficiaries to obtain IHT in relation to payments from pension schemes.
    - If income tax was paid, at this point HMRC could net off any over-(or under-) payment of income tax to ensure that income tax is based on the benefit net of IHT.

Illiquid assets

In theory, where members have more than one pension arrangement, it would be helpful if there was flexibility, subject to PSA's consent, for the IHT liability to be met other than proportionally across schemes. For example, if Scheme A holds the funds as cash whilst Scheme B would need to sell a property to fund the IHT charge, it would be helpful if as much as possible of the IHT could be met by Scheme A. In essence, this is the same flexibility as for the Estate itself. A complicating factor here is that the PSAs meeting the IHT liability are not the same as the PRs deciding on the allocation, so there would need to be safeguards to protect PSAs from a greater cash call than they had envisaged. Further, different PSAs might make different allocation decisions. Overall, we think the complexity outweighs the benefits.

A variation on this approach would be for pension schemes to join banks and building societies in the Direct Payment Scheme to pay IHT directly to HMRC if instructed by the PRs within a specific time limit. PSAs would then report the value of unused pension funds to the PRs. The PRs are then fully responsible for paying any IHT but could choose to ask PSAs to pay some IHT. This would need an amendment to enable PSAs to deduct IHT from the authorised death benefit. The IHT due could be limited to the amount reasonably assessed by the PRs as being due on pension assets as a whole.

Potentially HMRC might want PSAs to report to HMRC any unused funds over a limit (see Question 1) to make sure that the IHT was paid.

Amendments

Once the PRs have notified the PSAs of the nil rate band, that nil rate band could be fixed for those PSAs so that any subsequent changes to non-pension assets result in a change to the non-pension IHT due only.

Similarly, if any additional pension assets are discovered, there would be no further nil rate band applied (where it had already been used up). Admittedly, that would penalise beneficiaries of 'lost' pots. As an alternative, a nil rate band would only be applied if the additional pension liability was above a de minimis level – perhaps at least £25,000 (so that the IHT due would be £10,000).

Appendix 3: Consultation question 9: new “Pensions Inheritance Tax” is applied to pension.

We note that this is a technical consultation to implement the Government’s aim, as stated in the Autumn Budget 2024, of “removing the opportunity for individuals to use pensions as a vehicle for inheritance tax planning by bringing unspent pots into the scope of inheritance tax from April 2027.”[16].

Given the difficulties we have identified, we have considered an alternative approach which would meet the stated aims of limiting the scope to use pension schemes for inheritance tax planning and raising additional tax. We propose that instead of integrating pension schemes into the current IHT regime, the Government legislates for a new “pensions inheritance tax (PIHT)”. This could have its own timelines which would reflect pension scheme processes.

As noted in the introduction, there are a number of reasons why pension schemes benefits should be viewed differently to other assets held by the deceased.

There are many ways in which PIHT could be designed – the important point is that PSAs would need to be able to operate PIHT without needing information on other assets held by the deceased either in other pension schemes or outside pension schemes[17].

In order for there to be true separation, and if the same amount of tax were to be raised, there would initially be winners and losers compared to the IHT approach. It would be possible to adjust the PIHT paid so that beneficiaries are in the same position as under the IHT proposals, but similar issues would arise as discussed under Q2 for on account payments of IHT.

In this Appendix, we concentrate on a design that would support the fundamental principle that a pension scheme should provide for financial dependants and would be easy to administer.

Exclusion for dependants

Under this method, PIHT would not apply where payments (in pension or lump sum form) were made to dependants.

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[16] https://assets.publishing.service.gov.uk/media/672b9695fbd69e1861921c63/Autumn_Budget_2024_Accessible.pdf

[17] For example, if the proposals were to operate by way of a nil rate band, then either that would have to apply per scheme, or, if across all schemes, then it would need to operate in the same way as for LSDBA explained under “Inheritance tax always met by beneficiaries” in Appendix 2 whereby pension schemes pay the amount gross of PIHT up to the nil rate band and any additional PIHT due where members have more than one pension arrangement is levied by HMRC on the beneficiaries.

This would continue to enable interim funds to be distributed swiftly to any dependants who might face financial hardship if they otherwise had to wait for probate to be granted.

The following table compares the tax payable under the Government's IHT proposals with the PIHT approach, and would mean that:

Beneficiary	IHT payable on pension assets	PIHT payable on pension assets	IHT to PIHT comparison
Spouse's/civil partner's eligible for the IHT spousal exemption	No	No	No change
Other dependants: pension assets exceed nil rate IHT band available	Yes	No	Lower tax.
Other dependants: pension assets within nil rate IHT band available	No	No	No change
Non-dependant: IHT would be payable excluding pension assets	Yes	Yes	Depends on rate of PIHT. If PIHT is the same rate as IHT (i.e. usually 40%) then the total IHT + PIHT charge would be unchanged, but more would come from pension assets
Non-dependant: IHT only payable if pension assets are subject to IHT	Yes	Yes	Depends on rate of PIHT, but PIHT charge likely to be higher than IHT charge as PIHT would apply to more assets than IHT.
Non-dependant: no IHT would be payable	No	Yes	Higher tax

As the table above illustrates, broadly this approach would shift the extra tax raised from the IHT proposal from dependants (other than where covered by the IHT spousal exemption) to non-dependants. The group most likely to gain from this measure are minor children, those with a physical or mental impairment and financially dependent cohabitees. Non-dependants would always pay tax under this proposed approach[18] whilst they would only sometimes do so under an IHT approach.

[18] Unless there was a nil-rate PIHT band or small pot easements

In DB schemes, there have always been winners and losers – with those dying young with no dependants losing relative to those living long lives and/or their survivors doing so. A similar comment applies to DC schemes once an annuity has been purchased.

In our view there is a societal benefit in providing for dependants. This is supported by the trend towards providing greater protection for cohabitees within pension schemes[19].

Specific operational advantages include:

1. Instead of needing to identify whether a beneficiary met the complicated IHT spousal exemption rule, HMRC could define the beneficiaries that were exempt using definitions that are already familiar to PSAs.
2. In cases of financial hardship, benefits could be settled quickly with no need to identify PRs etc.

Operation

Calculation

PIHT should be applied to the amount actually paid/designated.

This would mean that HMRC shares in any change in value from the date of death to the date of payment – and so late interest charges should not usually be necessary.

However, to ensure that payments are not deferred for too long, it would be reasonable to legislate that PIHT is payable at the earlier of the date the benefit is paid and the end of the relevant two-year period. If PIHT is not payable at that point, then a higher rate of PIHT could be applied.

Where benefits are paid as a lump sum, PIHT could operate:

- As a one-off fixed rate charge applied before the lump sum is paid. There is no PAYE on the lump sum. This was the approach used for the Lifetime Allowance (LTA) charge, a process with which schemes are already familiar.
- As a one-off fixed rate charge with the net amount paid then subject to PAYE. This is the approach proposed in the IHT consultation.

The second approach is likely to be more appropriate to reflect the different financial circumstances of beneficiaries.

For deaths before age 75, the net amount would be assessed against the lump sum and defined benefits allowance in line with the current process.

[19] https://researchbriefings.files.parliament.uk/documents/SN03372/SN03372.pdf

Where benefits are designated to drawdown, we suggest that PIHT would operate as an initial charge on the amount designated, with PAYE on subsequent withdrawals.

Advantages of this operational approach include

1. Attempting to integrate with IHT would add additional steps to the death benefit settlement process that would result in additional costs – for DB schemes these would be borne by the employer, and for DC schemes additional administration costs may be reflected in additional administration charges deducted from all members accounts (not just those who end up paying IHT). A simpler system will be better value for members and sponsors.
2. Benefits would only need to be valued in line with the scheme rules – which might not require a valuation at date of death. This would simplify the calculations for administrators and be easier to explain to members.
3. This would remove the pressure on trustees to make decisions too quickly.
4. The tax deducted would not change if other assets were discovered elsewhere.

Reporting and payment

The PIHT payment would be reported in the Accounting for Tax return covering the quarter in which the payment was made and due by the standard deadline for that return.

This would fit with the established methodology for similar charges.

Appendix 4: Key definitions

Dependant: An individual who is classed as a dependant under Finance Act 2004[20] as eligible to receive a dependants' scheme pension. Essentially, this definition covers:

- Spouse/Civil partner[21]
- A child of the member if under 23
- A person (not a child of the member) who was financially dependent or interdependent on the member
- A person who was dependent on the member due to physical or mental impairment.

It does not cover adult children (age 23 or over) unless dependent on the member due to physical or mental impairment.

Pension Scheme Administrator (PSA): The legal liability for compliance rests with the PSAs; in a trust-based occupational pension schemes these are typically the trustees. The trustees typically delegate the day-to-day administration to administrators. In this response, we have not generally distinguished between where the PSA or their delegated administrator is taking the action.

The relevant two year period begins with the earlier of—

(i) the day on which the scheme administrator first knew of the member's death, and

(ii) the day on which the scheme administrator could first reasonably have been expected to know of the death

[20] https://www.legislation.gov.uk/ukpga/2004/12/schedule/28/paragraph/15

[21] Including, if the scheme rules so provide, any person the member was married to or a civil partner of when the member first started to draw a scheme pension. We understand this is to cover cases where payments need to be made following a divorce.