



## Reforming inheritance tax: unused pension funds and death benefits

### IFoA response

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers. Actuaries are big-picture thinkers who use mathematical and risk analysis, behavioural insight and business acumen to draw insight from complexity. Our rigorous approach and expertise help the organisations, communities and governments we work with to make better-informed decisions. In an increasingly uncertain world, it allows them to act in a way that makes sense of the present and plans for the future.

#### Who are the Institute and Faculty of Actuaries?

1. Actuaries are uniquely placed at the heart of the UK pensions system, trusted advisors working alongside administrators, lawyers, employers, insurers and trustees (and increasingly as trustees). As experts in managing long-term risk and pension scheme management, actuaries can play a vital role in putting pensions change into practice.
2. We are problem solvers and strategic thinkers, using our mathematical and analytical skills to help identify, measure and manage the risk of future events – and in pensions, that is over a very long time in the future.
3. The IFoA's policy and public affairs work seeks to inform and influence public policy, legislation and regulation to promote decisions and systems that serve the public interest. We do this by working with our members to promote the relevance and value that actuaries' expertise and long-term perspective can add to the understanding and good management of risks across society and over time.

#### Summary

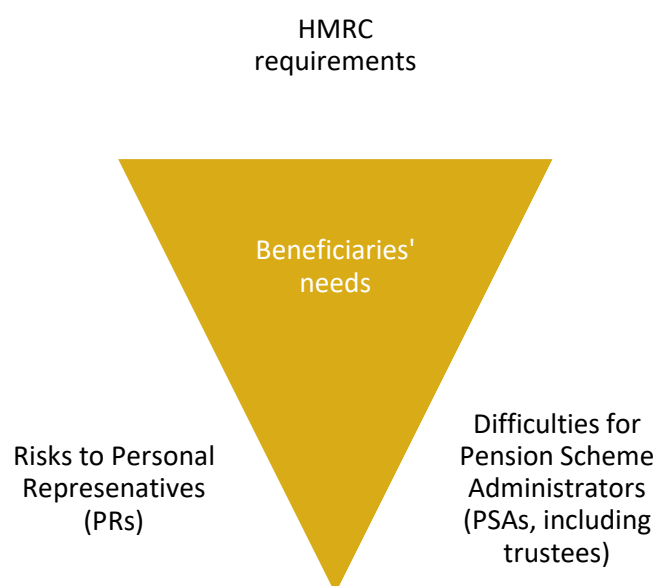
4. Background to our views is set out below. In summary, our three main concerns with the proposals are:
  - 4.1. **Complexity.** Integrating pensions and inheritance tax legislation (as opposed to finding a different mechanism for enacting the policy intent) is unavoidably complex which is likely to lead to unintended consequences, difficulties in implementation and potential delays to members receiving benefits
  - 4.2. Overlooking the role of pension schemes to provide benefits for dependants. By this we mean young children, unmarried partners, and disabled family members as currently recognised by HMRC pensions legislation. This is a core part of a pension scheme's purpose and the draft legislation does not fully distinguish between providing benefits to those dependent on the deceased member versus other categories of beneficiary where the benefits may be a 'windfall'.
  - 4.3. Inequality of treatment of different categories of dependant. As drafted, whether or not inheritance tax is levied varies depends on the category of dependant and also whether the members is in a defined benefit or defined contribution scheme. This is likely to lead to beneficiaries in non-nuclear

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family structures being disadvantaged and will likely be correlated to generational, ethnic and religious differences.

5. The Institute and Faculty of Actuaries (IFoA) responded to earlier consultations expressing concerns about the practical difficulties likely to arise from proposals to fully integrate pensions death benefits into the UK's inheritance tax (IHT) regime. We are pleased that following its winter 2024/25 consultation the Government took death-in-service benefits and reversionary dependants' annuities out of scope. We were also very pleased that the Government listened to Pension Scheme Administrators' (PSA's) concerns and shifted away from putting the burden of IHT liability on them.
6. Our members have (through their involvement in other industry bodies and in their employers' responses) sought to engage with HMRC on the detail of making its proposals workable. We expect those other parties will provide detailed information on the administrative difficulties of the present proposals – with which we would broadly agree – with suggestions about how they might be practically improved.
7. However, in this response we continue to express our fundamental concerns about the overly complicated approach the Government is taking to taxing unused pension funds on death, and the consequences for families after the death of an ordinary pension scheme member.
8. To be clear, it is a political question whether unused pension funds should be taxed on a member's death, and as a non-political professional body we take no view on that. Our points relate to the means rather than ends. We are strongly of the view that the foremost purpose of pension schemes is – and will always be – to provide good outcomes for members and their dependants in retirement. Our response here emphasises the impact on those dependants – provision for dependants after a scheme member's death is part of the proper purpose of pension schemes, and our concern here is driven by a concern that pension schemes should provide dependants with the benefits they are due, as quickly as possible, and without unnecessary tax uncertainty. We are particularly concerned about the “early/unexpected death” cases where pension schemes' benefits can provide a vital financial benefit for bereaved families whose financial security has been unfortunately – and perhaps unexpectedly – jeopardised.
9. In our view fully extending the existing IHT regime to pensions puts 4 sets of priorities in conflict, with the beneficiaries caught in the middle. Achieving all priorities simultaneously is impossible, and compromises will be necessary.
  - 9.1. **HMRC's Requirements:** HMRC wants full integration of pension schemes into the IHT system, removing the incentive to use pensions as a tax-avoidance vehicle and ensuring all relevant taxes are collected efficiently.
  - 9.2. **Pension Schemes' Needs:** Pension schemes aim to provide prompt payments to beneficiaries, especially dependants, without unnecessary withholding or delays.
  - 9.3. **Personal Representatives' (PRs) Concerns:** PRs need to avoid being held liable for IHT (and interest penalties) on assets they do not control, ensuring they are not unfairly burdened, and the beneficiaries of the members' estate unfairly affected. Many PRs are ordinary family members, not professionals, who would already struggle with the IHT and probate system, and they may be beneficiaries of the pension scheme themselves.
  - 9.4. **Beneficiaries:** They should be able to expect to receive their benefit entitlements without undue delay, in full, and without the risk that they are later liable for an uncertain amount of IHT. We are particularly concerned for financial dependants (i.e. under-age children, unmarried partners, disabled family etc., which we distinguish from legal spouses and civil partners, who are usually but not always exempt) who by definition were financially reliant on the deceased, not non-dependants

for whom death benefits might be considered “windfalls”. The impact on bereaved beneficiaries must be the central concern in any design.



10. Full integration of pensions into the IHT regime (which we distinguish from other ways of taxing pension benefits on the death of a scheme member – and note the current proposals are **not** a return to the pre-2016 tax approach) involves the bringing together of two already complex regimes, each independently evolved with their own vast systems of regulation and nuance. It is inevitable that this will not be straightforward, and that working through the many points of friction between the two regimes will run into difficulties. It would be highly regrettable if ordinary bereaved families were caught up in that friction.

## Response to the consultation questions

### *Identifying inheritance tax due*

#### **1. How challenging will it be for personal representatives to identify and report inheritance tax due on unused pension funds and death benefits?**

11. It may be very challenging in some cases.
12. A key problem is workplace pension schemes are set up for individuals by their employer (or former employer) often with very little involvement or understanding by the members concerned. Unlike trusts set up primarily by wealthier individuals, it is unfortunately common for pension scheme members to have little idea what assets are held for them (whether “in trust” or not), and to lose contact with the scheme after changing jobs. The personal representatives may therefore be delayed in becoming aware of a member’s scheme, and the scheme may not be informed of the death until some time (not infrequently years) after the event.
13. A second problem is the pension scheme trustees’ discretion in determining beneficiaries. They are not bound by a member’s will. The trustee process for determining beneficiaries takes account of all potential beneficiaries and so can take many months or even several years – and only then once the trustees are aware of the death.

### *Implementation and transition*

#### **7. How aware of the proposals are those who may be affected by the proposed change? What more should the Government do to raise awareness ahead of April 2027?**

14. Our understanding is that those using financial advisors and with significant wealth held in pension schemes into later life with IHT considerations in mind are particularly likely to be aware of the forthcoming changes.
15. However, the majority of ordinary scheme members are unlikely to have planned for, or understood, the IHT consequences of dying whilst they still have significant unspent pension assets, given that few people of working age give much thought to the work of their personal representatives after their death, and that they are not intending to use their pension as an IHT avoidance mechanism. Given there is an age threshold below which most scheme members cannot begin to use their pension funds, it is not clear to us what they would be expected to do differently if they were aware. This is a central point – most people save (and are encouraged to save) into pensions to provide for their own old age, and they will (and usually should) carry on with that saving irrespective of the inheritance tax treatment. They may be aware that the savings they are building up are a source of security for their financial dependants upon their early death, but this is usually a secondary consideration – it allows some benefit to their family if the member doesn’t survive as long as expected. Pensions saving is only an IHT avoidance strategy for a minority.

#### **8. What are your views on the proposed timetable for the introduction of this measure? Do you think there should be any transitional provisions?**

16. Pension scheme administrators need at least a year between the final law (including regulations) being known and the time of them coming into effect. This is because administration is complicated and carried out at scale. Every trust has its own trustees, procedures and rules. Automated systems take months to plan and make changes to. Ideally longer timescales would be provided as the pensions industry is already stretched dealing with existing initiatives such as the Government’s current Pension Schemes

Bill and pension dashboards. Assuming the Finance Act is passed towards the end of this tax year and regulations finalised soon after then we may have about a year – but this is getting tighter and it is not yet clear all the practical questions arising will be resolved by then.

17. It is very important that the full detail of the changes is clear to the industry at the outset of the implementation period. In an example of what can go wrong, the April 2024 abolition of the pensions lifetime allowance has required a fourth set of regulations to correct the Act and this has resulted in delays in people receiving their benefits.
18. We suggest that it is better for ordinary families (who will otherwise be adversely impacted by any lack of certainty) to delay implementation of new requirements until it can be done properly rather than rush to an arbitrary deadline.

### ***Consultation on both measures***

#### ***15. What are your views on the consultation process the Government has followed in relation to each of these measures?***

19. The fundamental policy of full inheritance tax integration was decided upon without consultation. Had the Government consulted on, for example, how to tax unused pension benefits at death, or how to avoid pension schemes being used as IHT avoidance vehicles, the problems they are now heading into could have been avoided, and other solutions considered that would have substantially met their policy intent with fewer difficulties. The consultation process begins with the fundamental approach having been decided – further discussion is then limited to trying to work out how to do that in the least worst way.
20. As already mentioned, we were pleased that the Government listened to feedback from pension scheme representatives as to how their initial proposals were impractical and would delay the payment of benefits to grieving survivors. We appreciate the Government has moved a long way from its initial proposals in response to its consultation.
21. While we are pleased to see that most (not just “insured” but perhaps not quite “all”) death-in-service benefits and reversionary dependants’ annuities (i.e. those bought by a member before their death to guarantee an income after their death to a surviving financial dependant such as an unmarried partner) are out of scope, it would have been better to clearly state those were out of scope from the outset.
22. In our earlier responses to the Government’s consultations we distinguished between payments to the surviving financial dependants of a member (e.g. unmarried partners, young children, and those dependant by reason of physical or mental impairment) and those to financially independent beneficiaries for whom the payments might be considered “a windfall”. Dependants of defined benefit (DB) scheme members will generally be out of scope from IHT; the burden of pension benefit IHT will fall almost entirely on defined contribution (DC) members’ families, and we would highlight the increasing public/private sector and generational divide between DB/DC provision. As noted at outset, provision for financial dependants is part of the proper purpose of pension schemes, and we think the taxation of death benefits should continue to reflect that.
23. In our consultation response we drew attention to several examples where the extension of IHT to pension scheme death benefits for dependants could leave them paying as high or higher combined rates of tax than some non-dependants would face, despite the Government’s stated concern that pension schemes were being used as tax planning tools rather than for funding retirement. Again, this did not seem to recognise that provision for financial dependants is a proper purpose of the pension scheme.

24. We have previously recommended the Government give more consideration to the impact on family formation, stability and breakdown, and we continue to urge the Government to consider and address this issue. For example, in the financially (and emotionally) distressed circumstances following the death of a young parent, there will often be a need for other family members to take on the care of any dependent children, particularly where another parent is not available to do so. The costs to the adopting family member are likely to be considerable. Similarly, all inherited wealth appears to be considered “fungible”, with no recognition that a surviving family member’s home is not just an interchangeable financial asset to be sold.
25. We also recommended the Government consider the ways younger families might be affected, particularly where there are more complicated circumstances than the “traditional nuclear family”. That would include considering how those impacts might be felt different for different groups, including each of the protected characteristics under the Equality Act 2010. We continue to suggest the Government reach out to stakeholders outside the usual pensions consultation community to better communicate the proposed changes and their impacts, and to understand these groups’ potential concerns.
26. The short equalities section of the [tax information and impact note](#) states “HMRC does not hold protected characteristic data on the beneficiaries of estates”. The Government’s consultation response did not discuss families or equalities-related concerns; however, we still think this issue should be examined further before pressing ahead.
27. Since the consultation we have learned that some legal advisors are discussing with pension scheme trustees whether to do away with their discretion entirely and adopt a codified approach to the award of pension death benefits. Death benefit decision making can already be a difficult and time-consuming process. Removing the IHT advantage and increasing the work for schemes to do give two reasons why trustees might want to “cut back” on the burden of discretionary decision-making. In our view this would be a deeply retrograde and regrettable step and be an unintended consequence of making the process difficult for pension schemes. Trustee discretion that needs to consider all potential beneficiaries is socially valuable in being one of the few legal-financial institutions that can properly investigate and recognise the complexity and variety of ordinary people’s personal lives when they die. Trustees often have more flexibility to consider “what would the member want us to do?” than the personal representatives. If that discretion is removed it will tend to be those survivors without legally registered relationships or in complex domestic circumstances that will be disadvantaged. We do not think this is the Government’s intention, but it should nevertheless pause to consider the potentially significant unintended consequences of its policy.

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