Chartered Institute of Taxation.

30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: technical@ciot.org.uk

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

Response by the Chartered Institute of Taxation

1. Executive Summary

1.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.

1.2. Our stated objective for the tax systems include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

1.3. We set out below our response to the proposal that from 6 April 2027 most unused pension funds and death benefits will be included within the value of a person's estate for inheritance tax (IHT) purposes. Our response considers the wider IHT impacts of the proposal and not just the administrative complexities of pension scheme administrators (PSAs) reporting and paying IHT.

1.4. We recommend the policy objective be achieved through an alternative approach of a separate Inherited Pension Death Benefit Charge (IPDBC) payable by the PSA when the unused pension or death benefit passes to a beneficiary who is neither a spouse nor a dependant of the scheme member. There would be no need for the personal representatives of the deceased (PRs) to identify the deceased's unused pension, nor to supply any estate information to the PSA(s). The PRs would administer the estate and deal with any IHT liability (as now) with little concern for the pension. This IPDBC approach would avoid the numerous practical difficulties

and associated costs for consumers that any form of integrated IHT regime would entail. It is explored in detail at Section 3 below.

1.5. If our alternative approach is not accepted, we recommend further consultation on the detail of the IHT proposals prior to carrying out a technical consultation on draft legislation. In particular, clarification is urgently needed as regards what is within scope of the new charge and what is exempt. This should be provided and consulted on prior to draft legislation being published.

1.6. While we agree that PSAs could report and pay tax on inherited pension funds, we also believe that the proposed method is overly complex and that there are alternative solutions.

1.7. Requiring PSAs to be liable for reporting and paying any IHT due on pensions to HMRC will overcomplicate the IHT system and delay both the administration of estates and, crucially, the payment of death benefits by the pension trustees to beneficiaries.

1.8. If IHT on pensions is introduced in its currently proposed form, we believe that existing pension scheme Accounting for Tax (AFT) processes could be adapted to report and pay the initial IHT due. However, there will be considerable difficulties for PSAs, PRs, pension beneficiaries and estate beneficiaries when further pension funds are identified, estate asset valuations change, or further estate assets are discovered. How the liability and burden for the final IHT liability should be accounted for in these and similar situations is problematic.

1.9. If using existing processes, the timing of reporting and payment should also align with existing pension processes rather than the current IHT payment deadline. The IHT reporting and payment timeframe is impractical with the added difficulty that interest is now at such high rates.

1.10. A simpler solution could be for PSAs initially to withhold 40% IHT, with exceptions such as when benefits are paid to a UK-resident spouse, and that the PRs and HMRC then agree the final IHT calculation, with any refund being issued proportionately to the relevant beneficiaries of the pension funds.

1.11. Another alternative would be to keep the estate and pension IHT processes entirely separate. All reliefs including the Nil-rate band (NRB) and Residence nil-rate band would be allocated as at present to the free estate and any trusts where the deceased had a Qualifying Interest in Possession (a life interest where despite the beneficiary only having a right to income, for IHT purposes the capital value of the trust fund is aggregated with their estate). As none of the value in the pension fund would benefit from those reliefs, we see merit in STEP's suggestion[1] that an entirely separate NRB be introduced, specifically for pension death benefits. This would be set at an appropriate level determined by the government, with any excess value taxed at the standard IHT rate of 40%.

1.12. We also think that it is important that there is equality in treatment for tax purposes of different types of pension arrangements, particularly between defined benefit and defined contribution pension schemes. To tax one arrangement where the pension trustees opt for an annuity arrangement to be paid to a dependant, but not the other because the scheme rules only provide for a dependant's scheme pension does not appear to be justified.

1.13. Most importantly, the current proposals will affect all estates, and not just those estates where IHT is payable. This is because of the process PSAs will need to go through to prove that no IHT is payable. We think it is essential that there are simple processes in place to enable pension death benefits to be paid to dependants

[1] step-comments-on-iht-on-pensions-liability-reporting-and-payment-final_0.pdf

and other beneficiaries quickly where it is evident that the estate is not liable to IHT without the need to go through the full process currently envisaged.

2. About us

2.1. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.3. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

2.4. Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

3. Alternative approach

3.1. Our members with extensive expertise in the administration of pension schemes and in the administration of deceased's estates agree that the proposal to subject inherited pension death benefits to IHT is fraught with practical difficulties and is likely to cause delays (resulting in increased cost and frustration for beneficiaries) in both contexts. The immense practical difficulties are explored in our answers to the Consultation questions below, but briefly are:

3.1.1. the number of information exchanges which will be required between PRs and PSAs,

3.1.2. the apportionment of the IHT nil-rate band between the estate and the pension fund(s),

3.1.3. the discovery of further assets, unused pension funds or changes in asset values during the administration impacting on the IHT ultimately due in respect of the various taxable components, and

3.1.4. the inherent uncertainty for PSAs, PRs and beneficiaries during the process – leading inevitably to significant delays both in paying tax and in distributing assets to beneficiaries (at what can be an emotionally sensitive time).

3.2. We suggest an alternative approach, which is grounded on two premises. The first is that pensions (and the associated tax regime) are intended to provide for the member and their dependants following retirement by age or ill-health. The second is that the 30 October 2024 policy intention is to 'bring most unused pension funds and death benefits' into a tax charge on the member's death. The approach we suggest below would, we believe, be consistent with both requirements, and achieve the government's policy objective in a far simpler manner. We are very keen to explore this further with HMRC.

3.3. Our alternative approach would be a separate Inherited Pension Death Benefit Charge (IPDBC) payable by the PSA when the unused pension or death benefit passes to a beneficiary who is not a spouse/dependant of the scheme member. There would be no need for the PRs to identify the deceased's unused pension, nor to supply any estate information to the PSA(s). Broadly, the PRs would administer the estate and deal with any IHT liability (as now) with little concern for the pension.

3.4. Each PSA (and it is increasingly common for people to have multiple pension entitlements) would be solely responsible for ensuring the IPDBC is paid in respect of their own fund, without having to be concerned about other pensions and the free estate. The payment of the IPDBC could be dealt with through the Accounting for Tax (AFT) return, with which PSAs are familiar, without the need (and cost) of setting up a separate, parallel system. Furthermore, there would be no additional delay for PSAs in following their normal discretion-exercising timetables and making payment to their beneficiaries.

3.5. We envisage that the IPDBC be charged when the deceased member's fund passes to a person who is *not* a dependant as defined in FA 2004, Schedule 28, paragraph 15 for the purposes of a dependant's scheme pension. This would provide for consistent IHT treatment for the death benefits of defined benefit and money purchase (defined contribution) members. Broadly, a dependant is a spouse or civil partner, a member's child under 23 or over 23 and dependant because of physical or mental impairment, or anyone else who was financially dependent on the member. The IPDBC would 'bite' when the fund passes to persons outside of that definition, typically to adult, self-sustaining children. Unused pension funds would therefore cease to be available as a tax planning tool to transfer wealth. By focussing on non-dependants our proposed IPBDC would avoid the unfairness inherent in the current proposals whereby pension funds passing to minors orphaned on the death of their parent at a younger age would be within scope of an IHT charge.

3.6. It also retains the protection against IHT charges for unmarried partners (provided for under pension schemes but not under the general IHT regime) – noting both that these would usually have been eligible to marry the member and exempt themselves from IHT (if they both choose to), and that the PSA will be able readily to apply this longstanding concept of financial dependant to determine who would and would not qualify. Furthermore, in aligning with the definition used for dependants' scheme pensions it would cover the rarer – but still individually important – cases where the deceased had financial responsibilities for someone other than a domestic partner or their own child, eg another family member.

3.7. However, if the policy intention is to provide parity with the deceased's non-pension funds (where a transfer to spouse/civil partner would be exempt, but a transfer to other dependants would suffer IHT) then – while it is not our preference – the IPDBC could be charged when the deceased member's fund passes to a person who is not a spouse/civil partner.

3.8. As all unused pension funds would be subject to the IPDBC (without the benefit of the deceased member's apportioned IHT nil-rate band) we suggest that the first £30,000 (mirroring the trivial commutation limit) be exempt. To avoid exploitation that single allowance could be applied to all pension funds under the control of one PSA. Recognising also that the IPDBC approach potentially brings into charge some unused pension funds which, even when aggregated with the deceased's free estate, would have not incurred IHT, we suggest that the rate of IPDBC could be set lower than 40%, perhaps at 30% or 35%, to compensate. When determining the appropriate rate government will have to balance the attractiveness of imposing a rate equivalent to IHT with the fact that a basic rate (or non-) taxpayer might be more heavily taxed on their death in respect of their contributions than any relief they were given on making those contributions.

3.9. We suggest that although the IPDBC should be payable by PSAs in the first instance, it would be open for PRs and beneficiaries of the free estate to reclaim some or all of the IPDBC if it later proved, for instance, that there was some unused NRB or similar.

3.10. We believe that an IPDBC designed along the principles outlined above would meet the government's policy objectives without the immense difficulties and costs associated with the IHT proposal.

3.11. Our answers below to the questions in the consultation are on the basis that our suggestion for a far simpler IPDBC model is not accepted.

4. Consultation response

4.1. 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?

4.2. We believe that PSAs should report whether or not there is an IHT liability unless the sums involved are de minimis. This will avoid confusion and discharge a positive statutory duty. It is at first sight attractive to say that PSAs should not be required to report unused pension funds or death benefits of scheme members to HMRC when it is known that there is no IHT liability on those funds or death benefits. However, the initial exchanges of information between the PRs and the PSA may be on the basis of incomplete information (eg undiscovered estate assets; further unknown pension funds) so that the IHT calculation performed on HMRC's calculator can only be regarded provisional until the estate is finalised, often a number of years later. PRs will need to know what payments have been made and to whom in all cases.

4.3. The only exception should be pension funds and death benefits paid to a UK resident spouse or civil partner. In this regard, an express legislative provision will be required to exempt payments to spouses and civil partners from IHT; in a discretionary pension scheme there are no 'rights' for the spouse / civil partner so that the spousal exemption under IHTA 1984, section 18 cannot apply; furthermore, the 'read-back' under IHTA 1984, section 144 currently applies only to appointments from a Will trust.

4.4. Will death benefits which are often separate from the pension element especially under section 226A policies remain tax free if nominated for others – they have never been capable of being paid to the deceased as a pension?

4.5. Aside from simple estates where everything passes to a UK resident spouse or civil partner, in every other case, no matter how small the estate is there will need to be liaison between the estate's PRs and the trustees / PSAs of each and every pension scheme the deceased person was a member of, and has unused pension funds or death benefits, in order to verify whether an IHT liability will arise, and if so what that liability is. The amount of work (and its attendant cost) that will be required of PRs and PSAs to establish any potential IHT cannot be underestimated.

4.6. The experience of our members administering deceased estates is that PSAs, for understandable reasons of caution to prevent fraudulent claims and to comply with GDPR and anti-money laundering rules, are often reluctant to provide any information to the PRs so a statutory duty must be imposed on PSAs to respond to requests for information by those appointed in the Will even before grant of probate. The position of Administrators before issue of a grant is even more problematic. Even identifying who are the relevant pension trustees in the case of someone who dies unexpectedly early with a number of undrawn pension policies with

no consolidation is extremely time consuming. The consultation seems predicated on a wealthy person who has retired with a single, large undrawn pension pot like a Self-Invested Personal Pension (SIPP). In reality, most average workers will have moved around over a working lifetime or through company mergers etc resulting in them holding many small pension schemes which are often difficult to track down; they are unlikely to have been consolidated if the person has not retired or is disorganised. PSAs will have lost contact with a member if they have moved houses frequently and members have found that even if notified, pension fund administrators are often reluctant to engage with the PRs or even dependant beneficiaries without a great deal of evidence. We can provide some typical correspondence with pension providers if this would be helpful.

4.7. In our members' experience, some pension trustees take 3 or 4 months even to respond to a letter and then only to ask for identification evidence.

4.8. The impact on cash-flow for beneficiaries at a sensitive emotional time cannot be under-estimated and anything that adds to delays (as these proposals will) therefore need very careful consideration.

4.9. There is a general liquidity problem on death. The PRs cannot access the estate assets without probate; they cannot get probate without paying the IHT; and they cannot pay the IHT without access to the assets. Quick access to pension funds is often one of the solutions that provides quick liquidity.

4.10. We would suggest legislating for a de minimis threshold for the value of unused pension funds and death benefits under which the pension scheme trustees / PSAs do not need to account for IHT.

4.11. 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?

4.12. We understand that pension scheme trustees / PSAs work to timelines based on notification of death to them, which can be many months after the death of the scheme member – particularly as the PRs and relatives may well not know about the existence of some pensions. Requiring IHT to be calculated, reported and paid on unused pension funds and death benefits within 6 months of the scheme member's death is likely to be very problematic.

4.13. Even if all relevant PSAs are notified promptly of the death of their scheme member, it is still likely to take some time to establish who the estate's PRs are, particularly in an intestacy or a contested estate. It is also likely that the PSA will have to wait for the PRs to be legally recognised before disclosing any information to them in order to avoid any breaches of confidentiality.

4.14. Existing timescales for pension scheme trustees / PSAs permit a maximum of 2 years to decide who should receive what benefit, without any adverse tax consequences arising. This runs from the date the PSA knew, or should have known, of the scheme member's death.

4.15. It seems to us that logically this same 2 year time limit should extend to the reporting and payment of any IHT liability arising on the unused pension funds or death benefits settled on beneficiaries as a result of the scheme member's death. This will necessarily mean the process should be separate from the grant of probate on the free estate which cannot and should not be delayed for 2 years. It would be a standalone process for pension funds.

4.16. If the requirement is unchanged and any IHT due on the pension fund must be paid within 6 months of death, then to avoid any interest or penalties arising, it would seem to us that in the very many cases where the liability to IHT cannot be determined before that date, the PSA would have to assume that all the unused pension funds and death benefits will be liable to IHT at the 40%, account for that to HMRC, and then reclaim

any overpayment at a later date. Any liability and penalties attaching to IHT on pension funds must be solely a matter for the PSAs.

4.17. 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?

4.18. We understand that while pension scheme trustees / PSAs will try to settle claims to the deceased scheme member's unused pension funds and death benefits promptly, in recognition of the often urgent need to ensure beneficiaries are able to continue to meet their outgoings, pension scheme trustees have fiduciary obligations to consider all potential claims on the scheme member's unused pension funds and death benefits, and must make reasonable enquiries to gather the necessary evidence before they exercise their discretion.

4.19. It can therefore take a considerable amount of time before pension scheme trustees can determine what benefits are to be paid to each potential beneficiary. In the absence of exemptions and de minimis thresholds it does not seem to us that there is a way to speed up the settling of IHT liabilities.

4.20. If anything, since from 6 April 2027 the pension scheme trustees will also have to take into account any potential IHT liabilities on unused pension funds and death benefits settled on beneficiaries, we would expect the exercise of the pensions scheme trustees' discretion could take longer as they will have to factor IHT consequences into any proposed distributions to beneficiaries.

4.21. As suggested above, we think that any IHT on a deceased scheme member's unused pension funds and death benefits should be based around existing timescales for pension schemes and would recommend a 2-year period running from date of notification or the date of payment to the beneficiary (if earlier) for reporting and paying any IHT arising.

4.22. If, however, HMRC insist that the IHT on pension funds cannot be a separate process divorced from the free estate we suggest that a statutory duty is imposed on PSAs to provide necessary information to PRs within a specified timeframe, eg 30 days of receiving notification of death. Two months (as suggested in the Consultation document at paragraph 2.24) is too long for the PRs. It may take considerable time for the PRs to identify the deceased's various pension pots. Simplifying the reporting process and clarifying liability between PRs and trustees could also help. Additionally, a digital platform for real-time information sharing between PSAs, PRs, and HMRC might also streamline the process.

4.23. Without a shorter timescale it will be impossible for PRs to calculate IHT liabilities overall including the correct pro-rating of the nil rate band. If there are any changes in the available nil rate band, eg further lifetime gifts are discovered that become chargeable on death, the PSAs should be made solely liable for their share of the additional tax due – no IHT liabilities attributable to the pension fund should be imposed on the PRs - it should be ringfenced as it is generally with trusts. The PRs do not have control over the pension scheme property and imposing liability on the PRs up to the value of the free estate in respect of pension funds would be very unfair to beneficiaries of the free estate who may not be beneficiaries of the PSA and would face significant liquidity challenges. We agree that the PSAs should be solely responsible for the payment of IHT on the pension fund unless the pension fund is actually payable to the estate.

4.24. The preceding two paragraphs address timescales from the viewpoint of the PRs. But from a PSA's perspective, short periods will be very challenging: although the value of the pension fund may not be difficult to ascertain, determining the potential dependants and then exercising discretion can be challenging and take some considerable amount of time. Only when that process is complete will it be known whether the pension fund is passing to an IHT-exempt spouse or civil partner, or on a chargeable basis to another dependant. This

illustrates the inevitable tension in attempting to force pension funds and the free estate into a single IHT regime.

4.25. 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?

4.26. We can see the potential advantages in using an existing quarterly process, the Accounting for Tax (AFT) return that PSAs are familiar with to report and pay any IHT due.

4.27. This said, our concern would be that the process for reporting and paying IHT should not cause delays in paying out benefits to beneficiaries.

4.28. To calculate the IHT charge on unused pension funds and death benefits, the PSAs will be dependent on the PRs of the scheme member's estate notifying them of the proportion of IHT due on the benefits to be paid. Even assuming that there are no delays in the probate process, nor in notifying the death of the scheme member to the PSAs, and that the pension scheme trustees are able to obtain all relevant information promptly to enable them to determine how they intend to exercise their discretion as regard payments to beneficiaries, there is still likely to be a time delay between providing the PRs of the deceased's estate with information on proposed distributions and receiving back from the PRs the calculation of the IHT due on each distribution – especially where the deceased was a member of more than one scheme.

4.29. The PSAs cannot therefore arrange reporting and payment of any IHT due via the quarterly AFT return until they have received notification of the proportion of IHT payable on each proposed payment to a beneficiary. Such reporting via the AFT return is highly unlikely to coincide with the proposal that any IHT due should be paid within 6 months of the end of the month of death.

4.30. Unless the 6-month reporting and payment deadline is relaxed we think that reporting via the AFT return is likely to lead to late payment of IHT. To avoid this a new reporting process will be required.

4.31. 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?

4.32. We think that once a distribution has been made to pension beneficiaries then, so long as the pension scheme trustees / PSAs acted in good faith and reasonably believed that either no IHT was due or the IHT withheld and paid to HMRC fully met the liability to IHT on that distribution, the pension scheme should cease to have any liability to pay more IHT. Without this protection a potential unintended consequence of the proposal is that PSAs will retain 40% (or more, to cover fees) of almost every pot for a substantial period until they have final clearance.

4.33. Instead, if it is determined that the distribution is liable to IHT or to additional IHT the liability should 'follow the money' and rest with the individual beneficiary. If that beneficiary has already spent their money it is not fair on other beneficiaries (pension or otherwise) that they should be liable on a joint basis for another's liability.

4.34. It seems inconceivable that once relevant benefits have been distributed to a beneficiary that the pension scheme will either have any funds out of which they can meet that IHT liability or be able to recover funds from the beneficiary to pay the IHT.

4.35. The Consultation document (paragraph 2.32 onwards) fails to appreciate the problem of amendments. It is a feature of the IHT regime that the amount of tax payable as the result of death is not determined conclusively

until the end of the administration when all assets have been identified, and all values finalised. There are, inevitably, changes between the initial payment of IHT due at 6 months after the end of the month of death, and the finalisation of the IHT liability at the end of the process.

4.36. Where there are (as now) two components – the free estate and one or more Qualifying Interests in Possession, the NRB and any Residence NRB are allocated proportionately. If previously unreported Potentially Exempt Transfers (gifts to an individual made in the 7 years before death) also come to light at a later stage, they may reduce the amount of NRB unused on death and consequently increase the IHT payable on the death components. A Variation of the estate under IHTA 1984, section 142 might also impact upon the final IHT figure. All these revisions will, on the current proposals, also affect pension funds. To stop interest running, any increase in IHT resulting from a change which is reported during the ongoing administration is normally paid as soon as possible. PRs and/or HMRC will have to communicate these revisions to the PSAs as they occur. The complications will be compounded if further pension funds are discovered after the initial NRB apportionment and IHT calculation.

4.37. Making the initial NRB apportionment final, regardless of subsequent asset and value changes, would not fit with the well-established structure of IHT, and be unfair on the components which might otherwise have benefitted from the revision. But it would be equally problematic, as explained above, when the IHT position is ultimately finalised to impose a greater liability on a beneficiary or PSA who may no longer have funds available.

4.38. That said, if (despite our misgivings) the government maintains that PSAs and pension beneficiaries should be jointly and severally liable for the payment of IHT, we think that the appropriate point for this to arise would be the point in time when the beneficiary receives a distribution from the pension scheme. Beneficiaries should obviously not be made liable for tax on benefits they have not yet received and may never receive. This should be expressly confirmed.

4.39. Will PSAs be able to obtain a certificate of discharge confirming that they have paid the IHT expected from that pension arrangement? Or will PSAs potentially be liable for inheritance tax for up to 20 years under IHTA 1984, section 240(7)? And what is the position if a scheme has been wound up?

4.40. In any discussion about liability it must be recognised that the free estate and pension funds are entirely separate entities. It is common for a deceased person to have made provision for certain dependants through pension arrangements, and for others by way of the free estate. The beneficiaries in each case will be different. For this reason there must be no question of pension funds (and their beneficiaries) or PRs (and the free estate beneficiaries) being made liable for any IHT shortfall in relation to the other.

4.41. 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?

4.42. If either the PRs or HMRC realise that an amendment is needed after IHT has been paid, the revised IHT liability should first be agreed between the PRs and HMRC, and then notified to the pension beneficiaries based on the details provided by both parties to the PSAs. In HMRC's case, we would expect the return made to HMRC by the PSAs to include the beneficiaries' contact details.

4.43. We would also expect PSAs to retain details of payments (contact details of the beneficiaries, types of benefit and amounts paid, IHT paid) for an appropriate period that aligns with their existing obligations to retain records for tax purposes.

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

4.45. While we note that it is proposed that the PRs should notify the death to the PSAs of each pension scheme the deceased has unused funds in or death benefits from, it should be recognised that it is often the deceased's next of kin and / or the potential beneficiaries of the unused pension funds that notify the PSAs. Unfortunately, often this happens some considerable time after the death of the scheme member.

4.46. Also, as noted above, the PSAs have a duty of confidentiality and therefore may be restricted in what information they can share with the PRs before such time as a grant has been obtained. A statutory duty or override is required to cover the release of information to potential PRs.

4.47. While it is suggested that PSAs will have 2 months in which to supply information to personal representatives, in reality, this is a deadline that is both too long for PRs and too short for PSAs. On the one hand the administration of the estate will be unduly prolonged and the chance of incurring interest on IHT unpaid at 6 months after the end of the month of death increased (exacerbated by the interest rate payable being set to increase by 1.5% to 4% above base rate from 6 April 2025). On the other hand, the pension scheme trustees / PSAs usually are not promptly notified of the scheme members' death and have their own due diligence and fiduciary duties, both of which are likely to delay when they can provide information to the PRs.

4.48. We welcome the proposal that there will be a new online calculator for PRs to use to calculate the proportion of IHT payable by the estate and the proportion to be paid on each distribution from a pension scheme of unused funds and death benefits which the relevant pension scheme trustees have determined will be made to beneficiaries. The sub-statement of IHT due to be passed by the PRs to the PSAs should provide some assurance that the proportion of IHT payable on payments to be distributed by the pension scheme has been correctly calculated. The PSAs should be able to rely on this calculation and sub-statement and should not be liable if it is subsequently found that the proportion to be paid by them has been incorrectly calculated, or changes subsequently.

4.49. That said, introducing apportionment of the IHT nil-rate band between the estate and the unused pension funds and death benefits introduces considerable complexity into the IHT regime. It will require repeated liaison between the PRs and PSAs. This leads to greater administrative burdens and costs as well as delays in settling an estate / its IHT liability. For example, each time a new asset comes to light or a valuation changes, there will need to be liaison between the parties not just in respect of the apportionment but, potentially, in respect of how the pension scheme trustees might exercise their discretion.

4.50. In this regard, a simple 40% IHT withholding charge by the PSA, in cases where it is determined that IHT will be due, might be preferable, with the final calculation and apportionment to be undertaken by the PRs at the conclusion of the administration. It must be recognised that this approach could cause hardship to the pension beneficiaries, and will inevitably add to costs as the PSA is obliged to revisit the initial IHT position.

4.51. It should be noted that the initial process of identifying unused pension funds and death benefits, notifying PSAs of the scheme members' death, PSAs then undertaking their own due diligence in carrying out enquiries to establish identities of potential beneficiaries, and pension scheme trustees undertaking their fiduciary obligations and exercising their discretion as regards the distribution of unused pension funds and death benefits can take a considerable amount of time. It is not a simple process. Having to take into account any potential IHT liabilities on distributions only adds to the decision-making process. Expecting this to be complete within 6 months of the death is likely to be unrealistic in very many cases.

4.52. There needs to be a carve out that permits pension scheme trustees to exercise their discretion and make payments to UK resident spouses and civil partners without waiting for any information from the PRs.

4.53. There should, in our view, also be an exemption to the normal process where benefits are to be settled on dependant persons, such as minor children, etc. There is already a disconnect between the tax treatment of married (including civil partnerships) and unmarried couples with dependants, and charging IHT on inherited pensions adds to this anomaly.

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

4.55. What would the process be where there is a dispute as regards who the legal PRs are? Or the beneficiaries of the estate? Pension scheme trustees are likely to be under some pressure to settle beneficiaries' claims and cannot wait for the courts to decide who the legal personal representatives are, or the outcome of claims under the Inheritance (Provision for Family and Dependants) Act 1975.

4.56. 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?

4.57. We think greater clarity is needed as regards what is and what is not liable to IHT under these proposals.

4.58. For example, it appears that dependants' pensions would not be in scope but a trivial commutation of death benefits paid to a dependant (who is not a spouse or civil partner) would be.

4.59. We would suggest that there should be a general exemption from IHT on pension death benefits for dependants. This could mirror the existing definition for dependants' scheme pensions, and would exempt unmarried partners, children under 23 and adult disabled children. This would also better align the taxation of death benefits from defined contribution schemes with those from defined benefit schemes.

5. Technical uncertainties

5.1. The proposals raise numerous questions which need addressing. These include:

5.2. What happens if a dependant's scheme pension is subsequently (maybe many years later) paid out as a trivial commutation lump sum?

5.3. It is unclear whether contingent annuities payable on a scheme members' death are in or out of scope of an IHT charge. If they are in scope, how should they be valued and how would IHT be paid given that the funds have already been passed to an insurer? Would there be considered to be a transfer of value at the time the contingent annuity was purchased? If so, how is it valued, and does liability lapse after 7 years, etc?

5.4. Are the remaining instalments of a guaranteed pension annuity within scope?

5.5. Death in service arrangements, which may be used to provide lump sum life cover of 'x' times salary under their own trusts appear to be outside the scope of the new IHT charge but pension scheme funded versions of these arrangements appear to be within scope. In neither case is there an 'asset' that the deceased can make use of whilst alive. These arrangements tend to be in place in case 'younger' individuals pass away prematurely in order to provide financial stability for their dependants.

5.6. There also appears to be significantly different treatment between the types of pension scheme in and out of scope of the IHT charge. Where a defined benefit arrangement (these days typically civil service or local

government) pays a scheme pension to a dependant this is out of scope of the IHT charge but is income for income tax purposes of the dependant. But where a defined contribution arrangement makes provision for a dependant's annuity, this is included for IHT purposes. This inconsistency appears to be unfair.

5.7. More fundamentally, what is an 'unused pension fund'? Prior to the deceased scheme member reaching normal retirement age the scheme member is unable to access their pension benefits (without incurring penal tax charges). So, if the scheme member dies prematurely, is a pension scheme that they cannot access an unused pension fund? Or is an unused pension fund a pension fund that has been drawn on, but the full funds have either not been fully withdrawn or not fully converted into a pension annuity?

5.8. An argument can be made that it is inequitable to impose a tax charge on people who effectively have no freedom of choice about drawing their pension fund or not. Those people have made pension investments over many years, encouraged by successive governments, yet in the event of a premature death will now be taxed. Excluding pension funds that cannot be accessed because the individual is below normal retirement age for that scheme would be in keeping with the principles of fairness and certainty in taxation whilst still tackling those 'older' persons that the government considers to be using pensions as a tax planning tool to transfer wealth without a tax charge.

5.9. Equally, clarity is needed where unused pension funds are liable to IHT as an asset of the deceased as to whether any annuity created out of those funds and paid to a beneficiary should be treated as a capital receipt or income of the beneficiary. It would seem inequitable to treat the funds as both a capital asset then also as income.

5.10. What happens where IHT has been paid on unused pension funds or death benefits and it is subsequently determined that a lesser amount is due (because the apportionment changes). For example, because a claim is made where an asset is sold at least than its market value on death. Who does HMRC make the refund to, the PRs, the pension scheme or direct to the beneficiaries? Logic dictates that the IHT refund should, ultimately, benefit the relevant beneficiary.

5.11. What happens if the estate is varied within 2 years of death and that increases the IHT liability? If the apportionment to the unused pension funds and death benefits changes who pays this liability?

5.12. Similarly, what if a lost and unclaimed pension fund comes to light? Will this change the apportionment of the IHT payment by the estate and the other pension funds or, if after a certain time, should it be treated as the 'top slice' so far as calculating IHT?

5.13. Who is liable for the interest if IHT is paid late? What if there are no funds left in the pension scheme to meet the interest charge, or the only funds left are those to be paid IHT free to a surviving spouse or civil partner? Interest charges could easily significantly reduce the value of a small pension pot, especially where it's a 'lost' scheme and it takes many months / years to discover that the deceased had paid into that scheme.

5.14. Where a SIPP owns agricultural land, woodland, or a business property it seems inequitable not to allow agricultural property relief, woodlands relief, or business property relief to the scheme that would apply were the asset held in any other trust or held personally. The rent on farmland is likely to be insufficient to fund the IHT, even over 10 years, thus forcing a sale.

5.15. Schedule 1A, IHTA 1984 makes provision for a reduced rate where charitable gifts are at least 10% of a component of the estate. This will require amendment to include pensions as a component.

5.16. We would expect that more estates will lose the residence nil-rate band (RNRB) by bringing them over the £2m threshold at which the RNRB is tapered away. This will also effectively increase the marginal rate of inheritance tax payable on the unused pension funds and death benefits.

5.17. Ideally, there should be a grandfathering rule such that those who have made long term plans based on a particular set of rules, eg flexible drawdown, are protected from this change. Stability and certainty is required when making long-term investments, such as saving for retirement through a tax incentivised pension scheme. Change operates as a disincentive. It would be an unfortunate unintended consequence if fewer people made provision for their retirement.

5.18. In this regard, we note that for Funded Unapproved Retirement Benefits Schemes (FURBS) the IHT position depends on whether the funds arose from contributions made before or after 6 April 2006. Funds paid out on the death of a member will normally escape IHT if they relate to contributions made to the FURBS before 6 April 2006[2] Will this exemption remain given that the contributions have suffered income tax?

5.19. How will the position on Qualifying Non-UK Pension Schemes (QNUPS) and Qualified Recognised Overseas Pension Schemes (QROPS) be dealt with? It may be difficult obtaining information from foreign pension trustees. Getting them to pay IHT may also be difficult. Are the PRs to be made liable for IHT on foreign pensions?

5.20. Unregistered pension schemes can still be subject to a section 3(3) IHTA 1984 charge if pension scheme benefits are not taken. As these schemes are unregistered and do not benefit from the tax reliefs available to registered pension schemes, it is assumed that the new ‘unused’ pension plan provisions on death will not apply. How will this interact with the new IHT charge on death, which will presumably apply to unregistered schemes as well? It is assumed that there will not be a double charge to both IHT and income tax.

5.21. What will be the position on pensions or annuities that cease on death and where there is no IHT due at present? Will the right to take that pension still be ignored on the basis that the estate is valued immediately before death when the imminence of death is obvious?

5.22. The new rules will impact decisions to transfer from defined benefit schemes to defined contribution schemes. Has this issue been considered?

5.23. Some schemes (for example, Small Self-Administered Schemes (SSAS) or SIPPs) hold commercial property occupied by the scheme member’s employer. Liquidity could be an issue if an IHT liability arises on the pension fund. Special provision should be made for these situations.

5.24. As noted earlier, we are of the opinion that these proposals should not target death-in-service benefits under a defined benefit (DB) scheme or death benefits written outside the members estate on the old section 226A policies. These are not ‘pension assets’ in the same way as investments held within a defined contribution scheme are. Clear guidance is needed on which pension schemes are affected and how any unused funds will be valued. For example, how will the following arrangements be treated?

- group life assurance (no associated pension benefits);
- relevant life policies / executive group life policies – presumably not affected as these are not registered pension schemes;
- protected value annuities; and
- guaranteed annuities.

[2] Para 56 schedule 36 Finance Act 2004

6. Alternative solutions under the IHT regime

6.1. The simplest approach to imposing an IHT charge on relevant unused pension funds and death benefits would be for PSAs to withhold 40% IHT on all payments to beneficiaries as a payment on account. Exceptions would include payments to a UK-resident surviving spouse or civil partner, payments to charity and a de minimis limit. This would ensure that any IHT due is paid to HMRC promptly. We have argued elsewhere that payments to dependants should also be exempt.

6.2. The PSAs could then provide a certificate of amounts paid and IHT deducted to the beneficiary and to the PRs of the estate. The PRs would then agree the final IHT liability on the estate and pension funds with HMRC and any overpayment could be paid back, ultimately to the beneficiary. We recognise that beneficiaries may suffer hardship in the interim.

6.3. Another alternative would be to keep the pension and estate IHT processes entirely separate. All reliefs including NRB and RNRB are allocated as at present to the free estate and any trusts where the deceased had a Qualifying Interest in Possession (a life interest where despite the beneficiary only having a right to income, for IHT purposes the capital value of the trust fund is aggregated with their estate). As none of the value of the pension fund would benefit from these reliefs we see merit in STEP's suggestion that an entirely separate NRB be introduced, specifically for pension death benefits. This would be set at an appropriate level determined by the government, with any excess value taxed at the standard IHT rate of 40%. This system would operate independently of the deceased's estate, simplifying administration by removing the need for PSAs to access detailed financial information about the broader estate and reducing the burden on PRs to allocate reliefs across multiple components. By making PSAs solely responsible for the calculation and payment of IHT on pension death benefits, this approach would avoid liquidity challenges for the free estate and its beneficiaries. Each component (free estate or pension) would be responsible for their own IHT, payable out of their own funds. However, unless there is a separate 'pension NRB' for each scheme of which the deceased was a member, the various PSAs would still encounter problems of liaison and exchange of information - only now it would be with their counterparts, rather than with the PRs.

6.4. Under this 'separation' approach, where the PRs can identify the PSA they will still notify this to HMRC who will then deal with the PSA directly. The PSA will be obliged not to pay out to the pension beneficiaries until the IHT is settled. The benefit of this approach is that there is no attempt to integrate two entirely different systems.

7. Conclusion

7.1. The vast majority of estates are under the IHT threshold and many pension funds are small. We would recommend that whatever process is introduced it includes de minimis thresholds under which the PSAs can make distributions IHT-free. This would remove the necessity of having to prove to HMRC's satisfaction that a small estate, including the value of any unused pension funds and death benefits, is valued at less than the IHT nil rate band.

7.2. Ultimately, it is crucial that PSAs are able to distribute funds to beneficiaries as quickly as possible (all the more important where the beneficiary is in financial hardship). Thus, whatever process is introduced to levy a charge

on the minority of estates where a liability arises, it must not delay pension scheme trustees in their decision-making process.

7.3. Pensions have an important social function of encouraging the individual to provide for financial security for them and their dependants after retirement. Repeated alterations made by all governments to the taxation regime are likely to act as a disincentive to save. Individuals require stability to make long term financial commitments. The effective ‘double tax’ charge (IHT and income tax) plus PSA management fees has the potential to make pensions an unwise choice for basic rate taxpayers, when compared with an ISA. A most unfortunate unintended consequence of the proposals may be that IFAs recommend many to steer clear of pension saving.

8. Acknowledgement of submission

8.1. We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

28 January 2025