THE SOCIETY OF PENSION PROFESSIONALS

making pensions work

The Society of Pension Professionals (SPP) response to draft legislation relating to inheritance tax on pension interests etc.

1. Executive summary

1.1. **The legislation should be amended to explicitly exclude the death in service benefits listed below from being in IHT scope in line with the Government's stated policy intention.**

1.2. **The requirement for members to be in "employment" should be replaced with a requirement to be in "employment or other service."** This will avoid inadvertently excluding certain categories of member benefiting from the IHT exemption applying to death in service benefits payable from registered pension schemes.

1.3. **An explicit exclusion from IHT for trivial commutation lump sum benefits should be inserted at section 150A(5).** This could be done by extending the sentence just above Clause 6.

1.4. **There should be a proviso at the end of section 226A (3) that the scheme administrator will not be required to pay an amount greater than the amount held by the scheme on the date on which the tax is paid.**

1.5. **Draft legislation requiring the scheme administrator to pay any tax within 3 weeks beginning with the day on which it receives the beneficiary's notice should be changed to 30 business days.**

1.6. **The scheme administrator should only be liable for interest that accrues on the amount specified in the notice as a result of late payment but NOT any interest that predates the notice and not any liability that is not specified in the notice.** The draft legislation should therefore be redrafted to reflect this.

1.7. **Greater clarity is needed on various issues including estate components, the omission to act, income tax reclaim and transfers of value.** See below at 2.29 – 2.42.

2. Consultation response

Apparent anomalies within the draft IHT legislation

a) Concerns that not all death in service benefits payable from registered pension schemes fall within the IHT exemption

2.1. **"Active" members**

2.2. The Government's stated intention as set out in its recent policy paper[1] is that "Death in service benefits payable from a registered pension scheme and dependant's scheme pensions from a defined benefit arrangement, or from a collective money purchase arrangement, are excluded from these changes and will not be in scope of Inheritance Tax, and accordingly a "death-in-service benefit" is excluded from the types of pension property which will be brought into a deceased individual's estate for IHT purposes under new Section 150A(5) Inheritance Tax Act 1984 (as inserted under clause 1 of the draft Finance Bill) .

2.3. New section 150A (6) provides that a death-in-service-benefit means:

"*a lump sum death benefit which under the terms of a registered pension scheme-*
(a) is payable in respect of the scheme in the event of the member's death, and
(b) is not payable unless the member is an active member of the scheme and in employment of a description specified in the terms of the scheme immediately before their death.

2.4. And new Section 150A (7) provides that active member has the same meaning as in section 151(2) of the Finance Act 2004 – i.e. "*a person is an active member of a pension scheme if there are presently arrangements made under the pension scheme for the accrual of benefits to or in respect of the person*."

2.5. However, as there is, arguably, no "accrual" in relation to a death in service benefit whilst the member is living with the benefit becoming payable when the member dies, death in service benefits which are provided via standalone death in service only registered pension arrangements may not meet the new definition and, consequently, would fall into the deceased's estate for inheritance tax purposes. The fact that a multiple of salary lump sum payable from a death in service only pension scheme would be subject to IHT, but the same benefit payable from a risk policy that the employer is running or a registered pension scheme that also provides pension benefits would not be, is a clear anomaly that needs to be corrected.

2.6. We have similar concerns over death in service benefits which continue to be provided within occupational schemes to deferred members who remain employed. Some defined benefit schemes that have closed to future accrual continue to provide death in service benefits to those employees who were active members immediately prior to the closure and who remain employed with the employer. The death in service benefit paid in this case would be subject to IHT. This means it is possible to end up with a situation where the death benefit payable in respect of one employee is subject to IHT because they are a former member of the employer's defined benefit scheme, but the death benefit payable in respect of another employee is not subject to IHT because, for example, it is payable from a risk policy.

2.7. Similarly, in the DC world, protected life policies e.g. pension term assurance, should be excluded given there is no concept of unused pensions funds here

2.8. Recommendation 1: The legislation should be amended to explicitly exclude all death in service benefits from being in IHT scope in line with the Government's stated policy intention.

[1] **Inheritance Tax on unused pension funds and death benefits, July 2025:**
https://www.gov.uk/government/publications/reforming-inheritance-tax-unused-pension-funds-and-death-benefits/inheritance-tax-on-unused-pension-funds-and-death-benefits

b) “employment”

2.9. Similarly, the requirement for members to be in “employment” could result in death in service benefits payable to members who are, for example, self-employed or partners in a firm, falling outside this carve-out. This does not appear to be in line with the policy intent. We feel that a requirement for members to be in “employment or other service” would be a preferable term and ensure that death in service benefits paid to members who are not conventionally “employed” would also be removed from the scope of IHT.

2.10. Recommendation 2: the requirement for members to be in “employment” should be replaced with a requirement to be in “employment or other service” to avoid inadvertently excluding certain categories of member benefiting from the IHT exemption applying to death in service benefits payable from registered pension schemes.

Other matters

2.11. Trivial Commutation Lump Sum Death Benefits (TCLSDB)

2.12. The confirmation that TCLSDB paid in respect of a dependant’s scheme pension should be excluded from IHT is welcome.

2.13. However, in this case, there should be an explicit exclusion for TCLSDB at section 150A(5). This is because section 150A(1) captures all scheme property that must or may, at anyone’s discretion, be used to pay a “relevant death benefit”, unless excluded by sub-section (5). On a strict reading, the mere option to pay the TCLSDB would arguably bring the funds into scope, even if the commutation did not go ahead, because without an exclusion a TCLSDB falls within the definition of a “relevant death benefit.”

2.14. Recommendation 4: an explicit exclusion from IHT for trivial commutation lump sum benefits should be inserted at section 150A(5). This could be done by extending the sentence just above Clause 6 so that it reads “….*“.. but does not include a dependant’s scheme pension, a trivial commutation lump sum death benefit paid to a dependant entitled to a dependant’s scheme pension, a dependant’s annuity or a nominee’s annuity that has been purchased together with a lifetime annuity payable to the member, or a death in service benefit*.”

2.15. It appears from [section 150A (1) in the draft legislation] that the value of a member’s defined contribution fund is determined as at the date of death for IHT purposes. As the member’s pot could fall in value and interest could accrue on the IHT, there is a possibility that the amount in the member’s pot will not cover the IHT and interest when the benefit comes to be paid out. If the scheme pays mechanism is used, the PSA’s liability should be limited to the funds held by the pension scheme in respect of the member. Similarly, in regard to the beneficiary, it is unclear whether it is appropriate for the beneficiary to be jointly and severally liable with the PR for the IHT and interest where that exceeds the amount they actually receive from the “estate.” In other words, is it right that a beneficiary could be required to pay IHT that exceeds the benefit they receive and fund this from their own resources, or should the amount of IHT that exceeds the benefit they have received be paid from the free estate? One way of overcoming these issues, would be to determine the value of a member’s defined contribution fund at the date of payment rather than death . However, this would not align with other property which is valued at date of death for IHT purposes, even though there is a risk that the property could subsequently fall in value. So, a more workable solution to address concerns about the member’s pot not covering the IHT and interest would be to have a proviso at the end of section 226A (3) that the scheme administrator will not be required to pay an amount greater than the amount held by the scheme in respect of the deceased on the date on which the tax is paid.

2.16. Recommendation 5: There should be a proviso at the end of section 226A (3) that the scheme administrator will not be required to pay an amount greater than the amount held by the scheme in respect of the deceased on the date on which the tax is paid.

2.17. Direct payments to administrative beneficiaries

2.18. In the draft new section 226A of IHTA 1984 subsection (5) requires the scheme administrator to pay any tax within 3 weeks beginning with the day on which it receives the beneficiary's notice given under subsection (2).

2.19. Given the practicalities of administration and the existence of public holidays and festivities (particularly during the Christmas and New Year period, but also during summer) this is an unreasonably short period. It should be noted that the process will involve the following steps:

- Opening and logging the receipt of the notice
- Checking that the notice is valid, satisfies the legal requirements and is properly given by an actual beneficiary
- Arranging for the disinvestment processes (if it is a defined contribution fund) – this will take at least three working days
- Contacting and liaising with scheme finance colleagues about arranging payment, with appropriate internal checking
- Internal authorisation and sanction levels to sign off payment, particularly if the amount is large – this can involve very senior people in some cases
- Making the payment into HMRC with necessary collation of information and collaboration to achieve the financial transfer.

2.20. By way of example, consider a beneficiary's notice received on Wednesday 15 December 2027. The deadline for payment would be Tuesday 4 January which would be a bank holiday in Scotland and the day after a UK bank holiday of Monday 3 January. The week preceding this would be an interval between the Christmas and New Year holidays that is often taken by staff as a holiday. In fact, the whole period amounts to 11 working days in Scotland and 12 in the rest of the UK.

2.21. We do understand why HMRC selected a short timeframe given the policy intention of payments needing to be made within six months (i.e. 26 weeks) of death if interest for late payment is to be avoided. However, we assess that the timeframe in the draft legislation is unreasonable and would often be missed with punitive consequences of non-compliance under 210(2)(b).

2.22. In our view, a more realistic timescale is at least 30 business days (which would be any day other than a Saturday, a Sunday or a bank holiday within the meaning of the Banking and Financial Dealings Act 1971).

2.23. We note that where the tax is being settled on a voluntary basis under 226A(4) that there is no timeframe for payment. This could provide a difficulty for the beneficiary because interest could be accruing and there is no recourse for them to get the scheme administrator to arrange payment . We suggest that the same timeframe for payment should apply to voluntary notices. However, there should be no penalty for non-compliance, and the liability of the scheme administrator should be limited to the amount on the voluntary notice.

2.24. Recommendation 6: draft legislation requiring the scheme administrator to pay any tax within 3 weeks beginning with the day on which it receives the beneficiary's notice should be changed to 30 business days.

2.25. Further examination of draft new section 210 of IHTA 1984, however, raises the issue of the liability definition in subsection (2)(b). This stipulates that the scheme administrator will be liable IF it is required to pay the tax in the notice under s.226A(3) AND fails to pay the tax before the end of the period described in s.226A(5).

2.26. This appears to imply that the whole liability for tax will potentially fall on the scheme administrator if it misses this deadline for a mandatory notice but otherwise no liability applies.

2.27. We suggest that this text is redrafted to simply stipulate that the liability is limited to the amount specified in the notice under s.226A(3). This is because, in some cases, the amount stated on a notice may not be the whole liability. For example, where the liability exceeds the death benefit lump sum payable or where a beneficiary intends to settle part of the tax from their own resources or from the wider estate. It would be wholly unreasonable for the scheme administrator to have to pick up the full tax liability bill just because they missed a short deadline to pay only the amount in the notice.

2.28. The SPP believes it would be fair for the scheme administrator to have to pay any interest that accrues only on the amount specified in the notice as a result of late payment but not any interest that predates the notice and not any liability that is not specified in the notice. We suggest the text is redrafted to reflect this.

2.29. Recommendation 7: the scheme administrator should only be liable for interest that accrues on the amount specified in the notice as a result of late payment but NOT any interest that predates the notice and not any liability that is not specified in the notice. The draft legislation should therefore be redrafted to reflect this.

2.30. **Estate components**

2.31. New section 150A brings pensions into the estate. There have been no consequential amendments to Schedule 1A. It is unclear whether or not the pension interest falls within the general component. It is also unclear if the intent is that for the 10% IHT charity reduction to apply, 10% of the total pension and non-pension assets must be given to charity.

2.32. **Omission to act**

2.33. Section 5 (2) omits s12A pension drawdown fund not used up: no deemed disposition. However, section 12 (2ZA) remains. Clarity is needed as to whether this is intentional and uncrystallised pension rights that are not taken when they become due will continue to be excluded from s3(3).

2.34. **Income tax reclaim**

2.35. Section 6 makes provision for the reclaiming of income tax. We do not believe the definition of TPI includes the special lump sum death benefits tax charge (45%), that is levied when benefits post 75 or pre 75 and after the 2 year window closes, where payments are made to non-qualifying entities, i.e. non bare trusts and estates. Again, clarity is needed as to whether this is the policy intention.

2.36. Furthermore, HMRC Trusts, in correspondence as part of LTA abolition, have indicated that Lump Sum Death Benefits that are paid pre 75 and within the 2 year window to a trust but are in excess of the LSDBA are capital payments subject to a 20% tax charge. However, there is nothing in PTM to suggest it would be subject to capital gains tax as opposed to the trust's income tax rate - which is 45% for discretionary trusts.

2.37. HMRC's Pensions Tax Manual states in various places that the death benefit is taxed at the recipient's marginal rate.

2.38. Further, section 637J(2) of the Income Tax (Earnings and Pensions) Act 2003, for example, provides that if certain conditions are met (i.e. the member is under 75, the lump sum is paid within 2 years of death and it exceeds the LSDBA) section 579A (pensions) applies to the lump sum as it applies to any pension under a registered pension scheme.

2.39. Again, clarity is needed here. If the amount of the lump sum that exceeds the LSDBA is taxed at 20% where the member dies under 75 and the lump sum is paid within two years, but it exceeds the LSDBA it would be helpful if HMRC could indicate what legislation is being relied upon.

2.40. **Transfers of value**

2.41. Section 7 states that the regulations apply to transfers of value on or after 6 April 2027. For clarity it would make sense if this were for deaths on or after that date.

2.42. If it is transfers of value, clarity is needed as to what transfers of value HMRC consider may happen and be within the scope of these new regulations after 6th April 2027. The legislation only deals with transfers of value on death. We can only think of annuitisation (subject to confirmation on omission to act).

2.43. Further to this, it is essential that clarity is provided as to what will happen if there is a pension transfer of value before 6th April 2027 and then a death subject to IHT after 6th April 2027. In such circumstances, will there be transitional rules? Will pre-April 2027 transfers of value be ignored? If not, presumably double charge relief could apply.

3. About The Society of Pension Professionals

3.1. The SPP is the representative body for a wide range of providers of advice and services to pension schemes, trustees and employers. Our work harnesses the expertise of our membership, striving for a positive impact on pension scheme members, the pensions industry and its stakeholders.

3.2. The breadth of our members is a unique strength for the SPP and includes actuaries, lawyers, professional trustees, DC consultants, investment managers, providers, administrators, covenant assessors, and other pension specialists, delivering a wide range of services.

4. Further information

4.1. For more information about this consultation response please contact SPP Director of Policy & PR at: phil.hall@the-spp.co.uk or telephone the SPP on 0207 353 1688.

4.2. To find out more about the SPP please visit the SPP web site: https://the-spp.co.uk/

4.3. Connect with us on LinkedIn at: https://www.linkedin.com/company/the-society-of-pension-professionals/

4.4. Follow us on X (Twitter) at: https://twitter.com/thespp1

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