Broadstone

Consultation Response

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

January 2025

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Executive Summary

We are pleased to be able to provide our thoughts via this consultation on the application of Inheritance Tax on pension funds.

We appreciate that the consultation focusses on the processes of assessing and collecting the tax in the event that a member of a pension scheme dies with assets not yet spent, and we do provide our views on this aspect.

However, we do think there are some issues with the policy proposal in general which we would also like to comment on.

In general, we are supportive of the government's aim to ensure that pensions are used for the primary purpose of providing an income for the member, and while individuals may have other assets to use in their retirement/later life we do not believe that pensions should be used as a wealth transfer. The changes made in 2015 which allowed for significant tax advantages on death benefits where the member is younger than 75 on death have always appeared unduly generous. Indeed, this became the ancillary "benefit" for those looking to transfer away from defined benefit pension schemes and was even often cited by scammers as a reason to transfer away.

Some concerns:

- The value and control of lump sums from defined benefit schemes
- The value and control of lump sums from death in service policies

Many defined benefit schemes pay out lump sums on death. However, these are often by scheme design and not any form of wealth transfer- they are purely functions of the scheme's rules. A good example of this is the lump sum guarantee. This would be paid in the event of the member passing away within a prescribed period of retirement (commonly 5 years). The unpaid balance of this initial set of instalments would be paid as a lump sum at the discretion of the Trustees to the beneficiaries. Cognisant the deceased's expression of wish and circumstances at death, we believe these lump sums should continue to be exempt from Inheritance Tax.

The position is similar for death in service lump sums. These will often be paid to younger/working age people experiencing a shock of early death. Thankfully by definition these are rare, but they are there to help next of kin at the worst possible time. The benefit put in place by the employer via a pension scheme or insured arrangement is there to help the family deal with the tragic loss of a partner or parent and we do not believe it should be in the scope of the policy to apply Inheritance Tax. Again, there is no wealth management or control on the part of the individual to manage an estate of funds via a death in service lump sum. This does feel like an attack on working age families who are being treated as if they are wealthy on receipt of a lump sum from an employer which is intended to shield them from sudden and long term income loss should the unimaginable happen..

Where complex family circumstances mean that the beneficiary of a death in service lump sum is a child there will be additional complications.

Both of these lump sums, if paid within 2 years of death, would be assessed against the Lump Sum and Death Benefit Allowance, and are subject to income tax or a standalone special tax charge. This seems sufficient should government policy wish to limit the size of these benefits.

Definition of spouse/civil partner

We are somewhat concerned about the differential treatment of spouses/civil partners when compared to “common law” partners, i.e. those who are living as committed partners but without formal union. Trustees have long been able to be agnostic about beneficiaries safe in the knowledge that ALL lump sum benefits they may award would be Inheritance Tax free. The change in scope and application of the Inheritance Tax rules allows for an element of spousal exemption. We understand that the tax benefits of marriage are of long standing and perhaps outside the scope of this policy, but we note this as perhaps an unintended consequence of the policy. Individuals who could have expected any lump sum payment in the event of death to be free of Inheritance Tax would no longer be able to simply due to the nature of their relationship.

Group life policies

We note that Annex B states ‘All life policy products purchased with pension funds or alongside them as part of a pension package offered by an employer are not in scope of the changes in this consultation document.’

One interpretation of the above wording is that registered group life benefits remain exempt from IHT. But there is doubt among colleagues and fellow people in the industry about how this interacts with other arrangements and to what types of polices you refer. We urge your clarification on this point.

Interaction of Lump Sum and Death Benefit Allowance (LSDBA), income tax, Inheritance Tax and the tax system

The introduction of Inheritance Tax on pension rights complicates the pension treatment of death benefits where the LSDBA is exceeded and so income tax as well as IHT would be payable. We are concerned whether this ratcheting up of tax charges is equitable. Has the government considered tweaking the existing tax charges on lump sum death benefits and application of the LSDBA as a means to control wealth transfer via pension funds?

We do see the political challenge of treating defined benefit and defined contribution pension rights differently, but it is the latter that are currently being passed on to dependants in a tax advantaged way and so the policy aim could be achieved more simply. As noted above, this could include amending the LSDBA process. Alternatively, has the government considered simply undoing the generous tax treatment of death benefits paid before age 75 and instead applying income tax to death benefits paid out for those individuals where it is settled within two years?

Access to data

We wonder whether the Pensions Dashboard programmes can be brought to bear and assist with this process. It would assist PRs if they can access the deceased’s data held on the Pensions Dashboard, speeding up the identification of pension benefits that may be held.

The process

Our key comments on the process are summarised below:

- HMRC should consider extending the proposed six-month deadline for IHT to be paid.
- Application of penalties and interest charges must be fair.
- This is creating a complex system and non-specialist individuals acting as PRs will need significant support to ensure proper tax treatment.
- HMRC needs to clarify data requirements for holding and reporting to HMRC should this be necessary in the years following death.

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Responses

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

Yes.

2- How are PSA 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?

The PSA will be left unable to settle the benefits. This will be a relatively straightforward scenario for a defined benefit scheme, as the funds will remain available to be paid across when the information has been received. For defined contribution schemes this may be more problematic, as there will need to be an assessment of how the funds have moved since death and what is actually payable. Clarity would be needed on this.

In addition, and applicable to all scheme types, there is the question of who is liable for any interest and penalty charges that could be due. The default should not be that these are met from the pension scheme assets, employer or PSA, who may well be innocent of blame for any delay.

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?

We have concerns about the proposed six-month deadline and suggest this extended to 12 months.

Some reasons for concern:

- Many cases when handling death benefits will exceed a six-month settlement deadline, even so-called simple cases. Identifying the Personal Representative, determining beneficiaries and of course the delay in being notified of the death in the first place. If the clock is ticking from date of death, then this will present a serious challenge.
- In our experience families come to this situation with little to no understanding of what is required of them and have to deal with multiple providers and other assets/liabilities while not overlooking arrangements to do with the death.
- Members resident overseas will also present challenges that can delay settlement.
- We note that the FCA has recently called for life insurers to improve bereavement handling times, and the proposed changes would seem to work against this initiative. Proposed changes would substantially lengthen the process to provide funds to bereaved families causing financial hardship to individuals that the FCA consider vulnerable customers.

We comment again that the six-month deadline for settlement before charges/interest apply should be extended.

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

This seems sensible. We note that some arrangements where the employer acts as the PSA and is responsible for the settlement of benefits may require an online account to be set up. HMRC should ensure that registration for online services is undertaken in advance of April 2027.

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

Yes.

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?

HMRC would need to clarify:

- What information the PSA should retain. This should only be essential data and not present an additional burden on the PSA to collect and store data not usually required?
- For how long this data should be retained. Different PSAs under different regulatory and legal frameworks may have different processes for the retention of data.
- How this corresponds with any GDPR requirements on PSAs and their ability to process data.

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

Any HMRC calculator should be as simple as possible to use. We are concerned at the ability of some PRs to handle the data and complexity of the calculations without issue.

It will be incumbent on PSAs to act on the advice of the PR and it should be clear that any error will not be the liability on the scheme, sponsor or PSA once those benefits and tax charges have been paid out.

We would also suggest that the Pensions Dashboard programme be engaged with to see how PRs can get access to the deceased’s dashboard data to help speed up any process.

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

We have concerns that so called “simple” cases are the exception not the rule.

- The interaction with complex family makeups will be a challenge.
- There are situations where PRs will not be family members.
- People who die young in service with partners and children will see a great deal of complexity in the way income tax, LSDBA and IHT charges interact.

HMRC will need to be prepared to assist individuals with complex matters. The wealthy (the main target) are more likely to have qualified professionals (advisers and accountants) who can assist in this process. Many more, will not.

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 Inheritance Tax due on those benefits? Are there any feasible alternatives to this model?

Given the increased complexity which will be involved, a de minimis or general rule of thumb to allow PSAs to pay out lump sums (akin to an emergency tax code) will speed up the distribution of benefits and reduce delay and cost. A true up via liaison with PRs and HMRC could be considered where relatively small sums are involved.

In addition, we request sight of the draft legislation as soon as possible in 2025 to enable the industry to properly scrutinise the real-world implications.