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Pensions and Inheritance Tax

Upcoming changes

From 6th April 2027, the UK Government proposes that defined contribution pensions will be subject to inheritance tax. This may impact upon the amount of inheritance tax that is due on your death.

This factsheet will focus on Defined Contribution pensions rather than Defined Benefit pensions. Defined contributions are those where a 'pot' is usually built up and to give you an income when you retire. There are no planned changes to the treatment of income tax on pensions on death; therefore, this factsheet will focus on inheritance tax, rather than income tax.

The Nil Rate Band and Residence Nil Rate Band

Inheritance tax is a tax paid on the estate of somebody who has died. In most circumstances, there would be no inheritance tax due if either:

- The value of your estate is below £325,000
- You leave everything above the £325,000 to your spouse / civil partner, or a charity on your death

Your allowances may increase by up to a further £175,000 (£350,000 for a married couple) if you own a home and leave it to a qualifying beneficiary (e.g., a child or grandchild) upon your death (The Residence Nil Rate Band). This means a married couple can potentially have a combined allowance of up to £1,000,000, meaning inheritance tax would only be due if their combined estate exceeds this amount. The RNRB can be restricted depending on the property value and for estates exceeding £2 million. If your total estate is worth more than £2m, the RNRB will taper off by £1 for every £2 above this threshold.

Changes from 6th April 2027

In the Autumn statement 2024, the Chancellor announced that unused pension capital will now be included in the calculation of your estate value for inheritance tax purposes. Personal Representatives and pension beneficiaries will be jointly and severally liable for paying any inheritance tax that is due on the pension. This additional burden is likely to increase the time and complexity particularly for non-professionals.

- If you have pension plans, ensure your records are up to date and accessible to your executors along with the location of your will and other financial information.
- Ensure your expression of wishes or nominations are up to date.
- Understand that any non-exempt beneficiaries will utilise your Nil Rate Band (for pensions from 6th April 2027).

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Example:
Brian and Linda are a married couple with two children. They have joint assets of £1.1 million and Brian has pension capital of £1 million.

Brian and Linda have mirror wills, leaving all assets to each other upon the first death and equally to their children upon the second death. Brian has completed a pension death benefit nomination in the following proportions: Linda 50%; Mark 25%; Jess 25%.

	Current Rules	From 6th April 2027
Brian dies	Linda inherits all joint assets free of inheritance tax. Linda inherits 50% of the pension free of inheritance tax. Mark and Jess each receive 25% or £250,000 of the pension pot free of inheritance tax. Linda now has £1.1m in assets and £500k in pension capital.	Linda inherits all joint assets free of inheritance tax. Linda inherits 50% of the pension free of inheritance tax. The pension capital passing to Mark and Jess is now subject to inheritance tax as they are non-exempt beneficiaries. The first £325,000 will utilise Brian's Nil Rate Band. £500,000 - £325,000 = £175,000. £175,000 will be subject to inheritance tax at 40%. £175,000*40% = **£70,000** due in inheritance tax.
Linda dies	Assuming her estate value remains the same, her executors can claim both Nil rate Bands and RNRBs which gives combined allowances of £1,000,000. The estate value is £1,100,000 so inheritance tax is due on the value above the allowances. £100,000* 40% = **£40,000** due in inheritance tax.	The taxable estate now includes the pension capital that she has inherited from Brian so her estate value for inheritance tax purposes is £1.6m. Brian's NRB has been used so is not available. Linda's executors can claim her NRB and 2 x RNRBs which gives total allowances of £675,000. The estate will be subject to inheritance tax on the value, minus the allowances, so on £925,000. £925,000*40% = **£370,000** due in inheritance tax

We can see that there was previously a £40,000 liability, and once the new rules are in place, this will increase by £400,000 to £440,000 (£70,000 + £370,000).

In this scenario, if Brian left all his pension capital to his wife upon his death, then there would be no immediate inheritance tax liability. On Linda's death, there would be a liability of £460,000. This would be due to tapering of the RNRB, as Linda's estate value would be over £2 million (she would lose £50,000 of the RNRB and so have total allowances of £950,000)

Summary: *This factsheet is for general information only. You should seek qualified financial advice regarding your situation and options to reduce your potential inheritance tax liability.*

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