PENSIONS AND LIFETIME SAVINGS ASSOCIATION

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Assets, Residence and Valuation team
HM Revenue and Customs
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THE PLSA'S RESPONSE TO HMRC'S CONSULTATION ON INHERITANCE TAX ON PENSIONS: LIABILITY, REPORTING AND PAYMENT.

1. We welcome the opportunity to respond to the consultation published by HM Revenue and Customs (HMRC) in relation to the proposed changes to inheritance tax on pensions.

2. The Pensions and Lifetime Savings Association (PLSA), a long-standing member of the HMRC Pension Industry Stakeholder Forum, is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

Introduction

3. The most significant tax decision relating to pensions taken by the Chancellor at the Budget was to extend inheritance tax to pensions from April 2027. Quirks of successive legislation have created the situation whereby certain scenarios can lead to pensions being inherited free of inheritance tax. The PLSA fundamentally believes that pensions should be used to pay retirement income to the individual that has accrued the entitlement, or their partner as their nominated beneficiary. The Government's overall policy approach of bringing pensions into scope for inheritance tax is pragmatic. However, it is important that it is done in a way that minimises any detrimental impact on members and beneficiaries, avoids discriminating against certain family units, such as unmarried couples, and minimises the burden on pension schemes and legal personal representatives. As such, we have significant concerns about the proposals set out in the consultation document that accompanied the Budget.

4. The decision taken by the Government to allow for a 30-month lead in period before the policy becomes effective is very welcome. The need for long-term policy planning when it comes to pension tax has been a longstanding call of industry. This allows savers to better understand upcoming changes, gives government departments the opportunity to design suitable legislation, with suitable transitional protections built in, and pension schemes the time to properly

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communicate concerns that need to be resolved. We appreciate the way in which that HMRC Pension Tax policy team have engaged with pension schemes since the Budget. The series of roundtables that they've hosted have been informative, and HMRC spoke directly to PLSA members at our event on inheritance tax and pensions.

5. However, the scope of the proposals needs clarification and, in our view, includes a process that has very real potential to be highly detrimental to members, beneficiaries and the pension industry. Specifically: the scope of the proposal as currently described would allow for the targeting of benefits that goes beyond what one would traditionally consider to be a pension, to take in life insurance related employee benefits which are designed to protect an individual's family in the event of their untimely death. In addition, HMRC is, in effect, proposing to outsource the sizeable administrative burden of inheritance tax collection onto pension schemes.

6. In the summary of impacts within the consultation, it is acknowledged by HMRC that there will be additional business costs to pension schemes[1]. This will be borne out by a significant increase in administrative outlay for pension funds. This is counter to the wider goals of the Government to reducing regulatory burden on business, and the wider goal of encouraging investment to boost UK growth. It should also be considered in the context of other significant policy-driven burdens on pension scheme administrators including the implementation of the dashboard, new requirements around decumulation and Digi RAS on the horizon.

7. The PLSA proposes an alternative approach. Our proposals remain aligned with the overall policy objective of bringing pensions into scope for inheritance tax purposes. However, they would simplify the way in which inheritance tax on pensions can be paid. This would result in a process which would as far as possible allow for the timely payment of pension lump sums to families, while at the same time alleviating the administrative and financial burden for pension schemes. It also builds upon existing practices and obligations for legal representatives of Estates within the current inheritance tax regime, rather than creating a new layer of regulatory requirements.

Summary of proposals:

8. We would strongly encourage HMRC to continue their engagement with the HMRC-chaired Pension Industry Stakeholder Forum as part of any consideration of post-consultation options. This will help ensure the final proposals are implemented effectively.

9. The legal personal representative of the Estate should be, as is currently the case with wider inheritance tax payments, responsible for the reporting and payment of any future inheritance tax due on pensions. This would avoid adding greater complexity to the tax system.

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

10. Estates should be given up to three months to notify the scheme following death. Estates should then be given a period of up to nine months to organise their finances (including going through the Grant of Probate process) and make the payment upon notifying schemes. This would be instead of the proposed six months from date of death. This would give Estates a total of twelve months to ensure all necessary payments have been made to HMRC before they incur interest on the outstanding amount due.

11. Schemes should provide Estates with financial literature and guidance on inheritance tax, thereby ensuring legal personal representatives are better supported as they manage any inheritance tax liabilities as a whole. This guidance could be produced either by the scheme or on a standardised sector wide basis. The PLSA would be happy to discuss providing this guidance with HMRC. A similar model operates for Pensions on Divorce guidance to ensure savers receive fair and consistent treatment.

12. Early clarification around the intended tax treatment of death in service benefits and certain DC annuities will be welcome. The PLSA does not envisage that HM Treasury is intentionally seeking to bring those into scope.

Response:

13. Our response is split into two sections. The first covers the scope of the policy and the appropriateness of the benefits that will be targeted. The second section focuses on the process of inheritance tax being paid on pensions.

14. Finally, we would like to make the related point that ahead of the Autumn Budget 2024, there was unhelpful media speculation about changes to the UK pension tax regime. Such reporting in the run up to any fiscal event can cause uncertainty and lead to savers making poor and reactionary financial decisions. In this case this was evidenced by the large uptick in people withdrawing their tax-free lump sums prior to the Budget who then subsequently tried to pay it back to pension schemes. We would emphasise the damage that such rumours can do both to individuals' financial circumstances, and trust in the system as a whole.

A. *Clarification of Scope*:

15. The PLSA agrees that some pension benefits should be brought into scope for inheritance tax purposes. This prevents quirks in legislation from being exploited as loopholes for tax avoidance. The integrity of the pension system is of vital importance to savers, the industry and government. However, the government must provide early clarification around the intended tax treatment of death in service benefits and certain DC annuities.

16. **Death in service benefits** - The consultation suggests lump sum death benefits payable from schemes will be included in the value of an individual's estate for inheritance tax purposes. There

is universal concern from schemes with members that are eligible for death in service-related lump sums about the consequences for the beneficiaries of active members who would receive this benefit. This specific lump sum is generally associated with the individual's employment status and it is designed to provide protection for an employee's family in the event of their untimely death. Amongst PLSA's members, it is clear that whilst this is a benefit that may be provided through a pension wrapper, it is widely considered to be a risk benefit provided as part of an individual's employment offering. Employees and employers also regard it to be part of their overall employment package, rather than a pension benefit. It must be stressed that pension schemes and their sponsoring employers have not designed the death in service lump sum benefit in such a way to avoid inheritance tax or to take advantage of the system by stealthily passing on wealth to the next generation. The payment of death in service lump sum tends to occur in the situation whereby a death was not foreseen, therefore making its timely payment to a bereaved family all the more important. This sum may be critical for many families in ensuring that the surviving family members are provided for in the event of a loved one's death and, if IHT has to be paid on this, it could lead to financial hardship. This is exacerbated by the fact that the tax position will depend on a couple's marital status with legal spouses and civil partners benefitting from an IHT exemption, whereas unmarried couples would not. This would mean an unmarried partner with children losing up to 40% of their partner's death in service benefits, whereas a married partner or civil partner would not. This difference in treatment is very difficult to justify and will lead to serious questions about the fairness of this policy. Further, pension scheme rules do not discriminate on the basis of partnership status.

17. As highlighted by the Association of Pension Lawyers (APL), the inclusion of this type of benefit into scope for inheritance tax appears to be the result of an oversight in the drafting of the consultation[2]. Death in service benefits are not classified as an unused pension fund or entitlement, therefore excluding this benefit from scope would not undermine the overall policy objective given that it appears it should not be in scope in the first place. If it is in fact government's intention to bring death in service lump sums into scope for inheritance tax, then this is not the appropriate way to do it. The government should consult separately with pension schemes, employers, trade unions and employees about the consequences bringing in employer provided life insurance products, written in trust, into scope for inheritance tax for the first time.

18. **Reversionary annuities** – Following the publication of the consultation, confusion has arisen concerning the intended tax treatment of reversionary annuities. As raised by Quilter[3], HMRC's proposals risk causing distress to beneficiaries that could be asked to pay tax on an income they are yet to receive (and that they may receive little of, if they die shortly after the original annuitant). The PLSA does not envisage that this is the outcome HMRC are seeking. Clarification from HMRC and HM Treasury is required.

[2] Briefing Paper – Overview of death benefit arrangements – Association of Pension Lawyers
[3] The cruel twist in Rachel Reeves's pension death tax plot

B. Process:

19. The process by which HMRC envisage inheritance tax on pensions to be paid should be revised. The current proposals will result in a costly and bureaucratic process that will cause delays in paying out benefits on the death of a member, could harm vulnerable beneficiaries and places significant unnecessary regulatory burden on pension schemes. This process could delay payments of pension benefits to families at a time when they need it most.

20. In order to properly explain why the PLSA is suggesting an alternative process for the tax to be paid, the following section first identifies the problematic elements of the proposed process. Accompanying this are the alternative proposals.

Inheritance tax to be paid by pension scheme administrators

Current proposal

21. The proposal in the consultation document for pension schemes to become liable to report and pay any inheritance tax due on unused pensions and death benefits to HMRC is troubling. This is a significant departure from the current inheritance tax model, whereby personal representatives (PRs) are responsible for calculating, reporting and paying any tax due from a person's estate. HMRC's rationale for this proposal is not evidenced and we can see multiple problems with it.

22. The outsourcing of inheritance tax collection to pension schemes is partly being put forward due to the unduly rigid timescales in which HMRC expect the tax to be paid, as we shall come on to later in this response. Whilst there is variation in how pension schemes administer their schemes, with some choosing to outsource to third party administrators and others having in-house teams, the knock-on effect of this policy will be increased costs and workloads for all schemes. HMRC's recognition of these costs in the consultation document do not go far enough; they are passed off as a 'one off' factor to consider. This simply does not reflect the reality of the impact that this process would have on schemes.

23. Not only will there be significant starting costs for schemes, there will also be costs extending into the medium and long-term. A large pension scheme informed the PLSA that they predict a cost to their organisation of several million pounds, over a period of 5 years, if the proposed changes were implemented in full. HMRC should bear in mind that not all schemes will have the capacity to cover this financial burden. Industry should be presented with a cost benefit analysis as soon as possible, instead of waiting for the publication of any draft legislation.

24. It is particularly worrying that there is no mention in the consultation document about the existing work pension administrators are doing to implement numerous changes in government policy and changes required following decisions of the Courts. A non-exhaustive list of the work currently being undertaken by pension scheme administrators includes work relating to the abolition of the lifetime allowance, pension dashboards, Governance Code, GMP equalisation and

the McCloud remedies. These pressures have been noted by The Pension Regulator (TPR)[4]. We would encourage HMRC officials to speak to TPR about this.

25. In her 2024 Mansion House speech, the Chancellor set out a timeline for significant consolidation of the industry. If implemented, the proposed inheritance tax policy would become effective within the same timeframe. Working through both of these new objectives simultaneously, on top of other ongoing areas of work, simply may not be deliverable for some or all schemes.

26. Beyond placing undue administrative burden on pension schemes and their administrators, this proposal does not recognise how engagement tends to occur between bereaved relatives and pension schemes following the death of a pension scheme member. Schemes rely on being informed of the death of a member in order to initiate the process of identifying and actioning payments to beneficiaries. For a range of understandable reasons, it is common for notification to be delayed. Feedback from our members indicates that in over 10% of cases, schemes are not informed of death for at least six months. In extremis this may be much longer, depending on the circumstances and jurisdiction of the death. If a saver has multiple different pensions, which is increasingly the reality following the introduction of automatic enrolment, this problem becomes greatly exacerbated as families may simply be unaware of the existence of some of their pension pots. This is a particular issue where a deferred member dies as they may have lost contact with their scheme a considerable time before their passing. When it comes to beneficiaries that are classified as vulnerable, HMRC must recognise that there can often be delays in communication between the pension scheme and the beneficiary. Schemes have legal duties of care, known as the Treating Customers Fairly (TCF) and Consumer Duty obligations. The current proposals do not take this into account, thereby greater risk of financial penalties being imposed on vulnerable individuals and pension schemes is present.

<u>PLSA alternative:</u>

27. We propose that we work with Government to redesign the process from scratch, to ensure that it is deliverable and that we avoid the significant unintended consequences of the proposal as described. This redesign should happen in partnership with the HMRC-chaired Pension Industry Stakeholder Forum. The forum contains broad industry representation and is ready to begin work in earnest to ensure the process is workable.

28. Any new model should be centred around the Estate, rather than the pension scheme administrator, being responsible for the calculation, reporting and payment of any inheritance tax due. This would be wholly aligned with existing precedence as to how other forms of inheritance tax are paid. Only the Estate will have full visibility of an individual's total finances. This is not information that pension schemes possess or can obtain.

Timescales:

[4] Why expanding our engagement with administrators will help drive better saver outcomes | The Pensions Regulator Blog

Current proposal

29. HMRC's selection of a six-month timescale for the inheritance tax to be reported and paid is unrealistic. The decision to have pensions included whilst existing probate timescales apply needs to be revisited. The six-month window before interest is levied, at a new significantly higher rate from April 2025, would unduly penalise the legal personal representatives of the Estates and pensions schemes[5]. It is incumbent on government that the process by which the tax can be paid is workable and compassionate. The proposal as drafted does not meet these criteria. In effect, the existing complex and technical rules around inheritance tax payments are being imported into the pensions tax regime (which is already complex in its own way). Further, we would ask that HMRC explain how it intends to manage the known problems that exist with delays in their processing of inheritance tax documentation. If, as predicted, many more individuals become eligible for paying inheritance tax once it is extended to pensions, HMRC must be equipped to deal with the increasing caseload.

30. By requiring schemes and personal representatives to exchange information in such a narrow timescale, many simply will not get the process completed in time, thus leading to harsh financial penalties for both Estates and schemes (or beneficiaries). This is compounded by the fact that delays may be caused through no fault of the scheme or the beneficiaries in question. In addition, it will not only be those with sizeable pension pots going through the process; every estate with pension wealth, regardless of size, will be subject to review to determine whether any inheritance tax is required to be paid. A wide cast net, with a short window of opportunity to resolve, will have harmful consequences.

PLSA Alternative

31. Regardless of whether it is the legal personal representative of the Estate or the pension scheme that is making the inheritance tax payment, the timescales are unworkable in a pension context. A degree of flexibility will need to be shown.

32. The PLSA proposes that HMRC should require the Estate to pay any inheritance tax due. The legal personal representative of the Estate should be given three months to alert the pension scheme from date of death, and then an additional nine months to make the payment twelve months in total from the date of death to make the payment before interest starts to accrue on the outstanding balance. In this scenario, schemes would have an appropriate amount of time to exchange all necessary documentation and make payments due to the Estate. Removing the scheme as an intermediary of the payment will have the benefit of one party, the Estate, paying any inheritance tax due to HMRC. This would prevent multiple payments from two separate parties – the Estate and the Pension Scheme.

33. Providing flexibility to Estates is an important step in getting payments made in a timely manner to HMRC. However, more can be done and there is a role for pension schemes in this part of the

[5] IFA Magazine – Higher interest rates on late payments

process. Once a scheme is informed of the death of their member, they can look to provide literature and calculations related to inheritance tax to the Estates. An example of where industry is currently doing something similar to this is the Pensions on Divorce guidance[6]. This will help to prevent any irregularities or discrepancies and help to ensure taxpayers pay the right amount of tax at the right time. This reduces the likelihood of secondary alignments having to be made. As inheritance tax on pensions is a new policy, material such as this will be crucial for Estates in the early days of the tax being effective. Schemes will be able to inform the Estate what type of benefit payment it is receiving from the pension and how that benefit interacts with the new inheritance tax regime. Given that HMRC predicts this policy will increase the number of Estates coming into scope for inheritance tax, educational material from schemes can help to bridge the financial literacy gap in the UK and prevent delays in payments being made to HMRC. We would encourage HMRC to engage with the PLSA and our members on this.

Conclusion

34. The PLSA agree with the government's overall intent to bring pensions into scope for inheritance tax. A pension is one of the most tax efficient ways for the public to save for their retirement. It is vitally important that the system is not being undermined by loopholes which permit pensions to inappropriately become vehicles for tax avoidance. The government is right to recognise that existing quirks in legislation should be rectified. We welcome the opportunity this consultation provides for us to provide feedback about best this policy should be implemented.

35. It is clear that HMRC officials are committed to finding a pragmatic outcome as to how inheritance tax on pensions should be paid. Whilst the PLSA strongly disagrees with the process suggested in the document, we hope the alternative proposals put forward demonstrate that it is possible for the government to address the problem it is seeking to solve without creating damaging unintended consequences.

36. Finally, the consultation has raised questions about scope that require clarification. The PLSA broadly agree with the benefits that are coming into scope of inheritance tax. However, HMRC and HM Treasury should clearly set out how they intend to treat death in service lump sums and certain DC annuities.

37. We would, of course, be happy to discuss any questions you may have. Please direct any questions in the first instance to **Jordi Skilbeck (jordi.skilbeck@plsa.co.uk)**

[6] Pension sharing charges: Pensions and Lifetime Savings Association guidance