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Inheritance Tax & your Pensions: What you should know

From April 2027, the UK government is changing how unused pension funds are treated for Inheritance Tax (IHT).

What is happening?

If you have a pension that is affected by the new rules, from April 2027 the value of this pension upon death will be added to your estate. If the total value of your estate (including your pension) is above the threshold – called the ***nil rate band*** - there will be 40% IHT to pay on the excess.

Who is affected?

Anybody with a **Defined Contribution** pension scheme will be affected. These are pensions that are, in effect, a 'pot of money'.

This will include personal pensions, such as those held with Quilter, Aviva, and Royal London. It may affect workplace pensions if the contributions are into a fund that has a visible investment value – this would include Additional Voluntary Contributions (AVCs) with Prudential.

Understanding the nil rate band

Inheritance Tax (IHT) is charged on estates above a certain threshold. The nil rate band is the portion of your estate that can be passed on tax-free. Anything else will be taxed at 40%.

- **Standard nil rate band**
  £325,000 per person. Therefore, if the value of your estate is less than £325,000, there will be no IHT due.
- **Residence nil rate band**
  Up to £175,000 extra if passing on your home to direct descendants. This includes children, grandchildren, and great-grandchildren but ***does not*** include siblings, cousins, nephews, nieces etc.
- **Spouses & Civil Partners**
  There is no IHT between spouses so you can transfer unused allowances, potentially doubling the tax-free threshold to £1 million (i.e. £325,000 doubled plus £175,000 doubled).

Who is NOT affected?

Those with **Defined Benefit** pension schemes will not be affected. In other words, pensions such as the Teachers' pension which provide a guaranteed income based on salary and length of service will not fall into the new IHT rules.

Defined Benefit schemes do not rely on a personal pension pot with a visible investment value, so they will not be included as part of your estate.

Are you affected?

The new rules will impact you if:

- you have a pension that is affected, and the value of that pension takes you above the nil rate band.
- you are already above the nil rate band. That means the entire pension amount could now face IHT as part of your taxable estate.

If unsure, a quick calculation can help indicate whether you may be affected. Add together the following:

- The total value of all your affected pensions
- The total value of all your assets, investments, and savings
- The total value of your home ***only if not being passed on to a direct descendant***

If this figure is less than £325,000 (or, in effect, £650,000 if you are married) then no IHT will be due.

If your home is being passed onto a direct descendent, there is an extra £175,000 allowance (£350,000 for a couple). This can bring your total assets before IHT is due to £500,000 (or £1 million for a couple).

Some considerations

The average life expectancy in the UK is now around 82 and gradually rising, according to the Office for National Statistics. For a married couple aged 65, there's a 50-60% chance at least one partner will live to age 90. You may still have many years before your IHT bill is a consideration.

In that time, pensions, investments and savings may grow and house prices may go up. Your assets now will likely be more in 10 years' time, and even more in 20 years. However, the nil rate band hasn't changed since 2009 and the government has confirmed it will be at least 2031 before any change occurs. We would not expect a radical change if or when this happens.

It is possible that, while you are not in an IHT position at present, you could be in the future. Pensions now being part of the estate further increases that chance.

What should I do?

This does not need urgent action. There is still over a year before the rules take place and you still have an annual review before this time. If you believe you are affected, your review would be a good time to start considering your options. This would also be a good opportunity to update us with your assets and savings, and to ask any questions you may have.

Assumptions: Inheritance Tax can be complex and can cover many scenarios. For ease, the figures and scenarios used above have been kept free of complications such as giving to charity, agricultural or business property relief, trusts, and overseas assets.

Please also note that the above is based upon the proposals as they are. While we do not expect big changes, nothing is yet set in stone, so changes are possible.

This information is based on our current understanding of taxation, legislation and regulations. Any levels quoted and reliefs from taxation are subject to change. Tax implications will be based on your individual circumstances.

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