

LCP's response to HMRC's consultation on unused pension funds and death benefits

22 January 2025

This document sets out LCP's response to HMRC's consultation document: [Inheritance Tax on pensions: liability, reporting and payment published on 30 October 2024](#) (the "Consultation").

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have over 1,000 people in the UK, including over 180 partners.

The provision of actuarial, investment, covenant, governance, pensions administration, benefits advice, and directly related services, is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, including the application of the pensions tax regime to benefits. The remaining 20% relates to insurance consulting, energy, health and business analytics. LCP is regulated by the Financial Conduct Authority for some insurance mediation activities only and is licensed by the Institute and Faculty of Actuaries for a range of investment business activities.

Executive summary of our views

In our view there are four key material issues with the technical proposals for the application of inheritance tax (IHT) to unused pensions and death benefits:

- The process will delay the payment of all lump sum death benefits to widows, widowers, civil partners, dependants and beneficiaries, no matter whether any IHT is due, to the detriment of those in need at a time of bereavement and create disproportionate costs and workloads for personal representatives (PRs), pension scheme administrators (PSAs) and HMRC.
- The deadlines are unachievable, meaning that there are likely to be a very significant number of amendments, resulting in unnecessary costs and workloads for PRs, PSAs and HMRC, and inappropriate penalties being deducted from benefits to beneficiaries.
- The process requires personal and sensitive data to be shared more widely than necessary, increasing the risk of data breaches and conflict within families.
- The Consultation has not been clear on which benefits are in scope of the new measures, meaning that a whole group who are potentially affected have not engaged with the consultation as they have not realised the measure might affect them.

We believe these issues can be addressed as follows:

1. Avoiding delay, amendments, disproportionate costs and data protection issues

Option 1: PSA pays gross

The PSA could pay unused pension funds and death benefits gross of IHT, report the details to HMRC and HMRC could collect the tax due. This mirrors the existing process for payments in excess of the lump sum and death benefit allowance.

In parallel the PR could report and pay IHT on the non-pension estate to the existing timescales.

To make the process achievable for the PSA and fairer on the beneficiaries, we propose that any penalties or interest in respect of IHT on the pension benefits only apply from the earlier of 2 years from the end of the month of death or 2 months from the date of any demand from HMRC.

Looking across a wide range of pension schemes, fewer than 50% of death benefits are paid under the current regime within 6 months of the end of the month of death. Timescales are only likely to increase if a new process has to be followed.

To minimise the transfer of personal data, the PSA would only provide information on the beneficiaries to HMRC.

In a situation where the pension benefit (paid gross of IHT) is subject to income tax, the PSA would report the income tax paid to HMRC so HMRC could calculate any refund of income tax due and net this off the IHT payable.

Option 2: Targeted tax deductions

A streamlined process could apply for payments to an exempt beneficiary, with minimal reporting, as no IHT is due.

The deduction and payment of the correct IHT by the PSA could take place where all information is available to do so without causing delay in payment of benefits from the pension scheme, with limited reporting to the PR to protect personal data and full reporting to HMRC. This would include not just cases where the beneficiaries have been confirmed but also cases where it had been established that there was no IHT due.

A default process could be set by HMRC whereby the PSA deducts and pays IHT based on an assumed nil-rate band allocation where information is not available to complete the correct calculation without causing delay in payment of benefits from the pension scheme. HMRC would then process any amendment / refund with the beneficiaries and PR direct. As for Option 1, any IHT amendment calculated by HMRC could also allow for any amendment to the income tax due.

We believe a default process set by HMRC based on an assumed nil-rate band allocation is key if PSAs are to have a liability in respect of IHT. Otherwise HMRC could be flooded with refunds to process or beneficiaries could suffer unnecessary delay in receipt of benefits.

As an example, 75% of lump sums on death we paid in 2024 were less than £10,000 per death.

The PR could report and pay tax on the non-pension estate to the existing timescales. The PSA could be required to report and pay to HMRC the IHT being deducted from the benefit within one month of the net benefit being paid to the beneficiary.

We have set out more details of how Option 1 and Option 2 would work in Appendix 1.

Under neither Option 1 nor Option 2 would the amount of tax due change from that proposed by HMT / HMRC. Both will significantly reduce the number of amendments and tax receipts and refunds HMRC will need to process.

Both address data protection issues in the process proposed by HMRC.

Amendments

We believe two key steps are required in relation to amendments, given they are likely in volume under a regime where the IHT due across the benefits from each pension scheme depends on the value of the estate and the benefits payable from any other pension schemes:

- The whole probate / IHT process needs to be digitalised with data on all assets in respect of an individual linked together despite being submitted by different users and amendments submitted electronically.
- Amendments need to consider the net position, as in many cases it may be that too much IHT has been deducted from one asset (pensions or estate) and not enough from another – it would not then be reasonable to be applying interest at different rates on the under and over payments, nor penalties.

Speeding up notification of death

Many pension schemes already use tracing agencies to speed up the process of identifying if members have died. We recommend HMRC seek to make these processes even more efficient by sharing data from “tell us once” with these agencies and also speeding up the sharing of data from death registrations.

2. Issues with scope

Insured life assurance only trusts

The Consultation states that a “defined benefits lump sum death benefit” from registered pension schemes will be in scope of the new regime but also notes “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.”

Many have taken this to mean that where multiple of salary life assurance benefits are provided by an employer through a life assurance policy they are not in scope of the new regime even though those benefits are provided through a trust registered with HMRC as a pension scheme and the proceeds of the life assurance policy are paid as a defined benefits lump sum death benefit. They have not therefore responded to the consultation to explain the issues that would arise if such benefits and arrangements were in scope of the new regime.

We raise this point as such life assurance only arrangements are often used by employers to provide life assurance cover to their employees and there is no PSA and no one registered to make tax payments to HMRC. If these arrangements were in scope there would be a significant burden on both employers and HMRC that has not been recognised in the consultation process.

Inconsistencies in treatment

The Consultation states one of the policy objectives is to “align” the treatment of death benefits. We note the scope of the measures set out in the Consultation creates new inconsistencies. For example:

- A pension to a unmarried partner or child who was financially dependent on the deceased will be out of scope if paid from a defined benefit scheme, but in scope if paid from a money purchase arrangement.
- A lump sum multiple of salary death benefit paid from a pension scheme funded on an uninsured basis will be in scope but it appears if it was insured it might not be in scope and if provided outside a pension scheme will not be in scope.

Appendix 2 sets out further comments of a more detailed nature regarding the proposals.

Next steps

We welcome the open and constructive way the initial consultation has been run.

We believe a further short (say 4 to 6 week) consultation needs to be completed in the spring to consider a revised approach, before moving on to consultations on draft legislation, guidance and the online tool for allocating the nil-rate band later in the year.

Given the extent of the changes to processes and systems that will be needed by both HMRC and PSAs, we believe clarity on the detail of the new regime will need to be in place by April 2026.

We are happy for LCP to be named as a respondent to the consultation and happy for our response to be in the public domain. We are happy for you to reference our comments in any response.

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Appendix 1

Avoiding delay, amendments, disproportionate costs and data protection issues

Option 1: PSA pays gross

The Consultation states that only a very small number of estates will be liable for IHT. A way to avoid any impact on the vast majority of estates and beneficiaries without changing the tax due would be:

- For PSAs to pay death benefits gross of IHT;
- For PSAs to report to HMRC details of payments and beneficiaries where the transfer was not exempt (ie beneficiary was not a UK resident spouse / civil partner);
- For HMRC to calculate any tax due from the beneficiaries taking into account information reported to HMRC by the PR from the non-pension estate and any income tax deducted by the PSA.

We believe that it would be more efficient for HMRC to calculate and collect the tax once in the few cases where tax is due than for HMRC to have to process the significant number of refunds and amendments that would arise under HMRC's proposed process.

Option 2: Targeted tax deductions

If HMRC feel strongly that PSAs need to be deducting IHT in some cases, a targeted approach without changing the tax due would be:

- In cases where the transfer is exempt (ie beneficiary was a UK resident spouse / civil partner):
 - For PSAs to pay death benefits gross of IHT (as none is due);
 - For the only disclosure from the PSA to the PR being that the benefits (if any) were exempt from IHT (no need to disclose the value of the benefit nor who it was paid to);
 - No reporting from the PSA to HMRC.
- In cases where the transfer is not exempt (ie beneficiary was not a UK resident spouse / civil partner) and where information is not available to complete the correct calculation without causing delays to payment:
 - For the cases where the value of the benefit in respect of the deceased was less than a "de minimis" threshold (of say £10,000):
 - For the PSA to pay the death benefits gross of IHT;
 - For the PSA to report to the PR the value of the non-exempt benefit paid but not to whom it was paid;
 - For the PSA to report to HMRC the value of the non-exempt benefit paid and to whom it was paid.
 - For the cases where the value of the benefit in respect of the deceased was more than a "de minimis" threshold (of say £10,000):
 - For the PSA to pay the death benefits net of IHT, assuming the nil-rate band allocation was £10,000;
 - For the PSA pay the IHT deducted to HMRC;
 - For the PSA to report to the PR the value of the non-exempt benefit paid and the assumed nil-rate band allocation, but not to whom the benefit was paid;
 - For the PSA to report to HMRC the value of the non-exempt benefit paid, to whom it was paid and the amount of IHT paid.
- In both situations, HMRC would then calculate if IHT has been over or underpaid by each beneficiary considering the estate and pension assets as a whole and process any amendments with the beneficiaries.

Appendix 2

Points of detail and wider observations

1. **Education:** PSAs are unlikely to be experts in IHT having not previously needed to consider it. Time and support will be needed to help them understand what they need to do under the regime.
2. **Reversionary annuities:** An annuity might be purchased within a pension arrangement prior to death that will be payable following death of the member to a financial dependant who is not the legal spouse or civil partner. We do not believe it is practical to apply IHT to this asset as the beneficiary would not be able to surrender the annuity to meet the tax bill. Given that a corresponding pension paid from a defined benefit arrangement will not be in scope of IHT, we consider it appropriate for a “dependants annuity” to be out of scope where payable to a financial dependant or purchased prior to the announcement of the new regime.
3. **IHT reliefs:** We understand that relief from IHT can apply in certain circumstances, such as when an asset falls significantly in value after the date of death. A reduced rate can also apply if a certain proportion of the estate is donated to charity. Clarity is needed on if and how these provisions will apply to and interact with unused pensions assets and death benefits.
4. **Overseas members, spouses and civil partners:** Clarity will be needed regarding the implications of the member and/or spouse/civil partner being resident overseas and what steps a PSA can reasonably be expected to take to establish the position.
5. **Moving to a non-discretionary basis:** Switching from a discretionary to a non-discretionary allocation of death benefits will not be sufficient to solve the issues with the regime proposed by HMRC. If the PSA is to be required to deduct IHT from the benefit, they need to know the nil-rate band allocation. The process proposed by HMRC will therefore have a material impact on all schemes.
6. **Paying benefits to the estate:** Likewise, and for the same reason, switching to paying death benefits to the estate will not be sufficient to solve the issues with the regime proposed by HMRC.
7. **Pension Dashboard:** Pensions dashboards could only be of limited use in helping PRs identify pension assets because (i) a way would need to be found to provide the PR with access without opening up the data to all, (ii) data for pensioners is not on the dashboard, and (iii) small schemes are not on dashboards.
8. **Reliance on the PR:** The regime proposed by HMRC requires the active participation of the PR. Where the non-pension estate is small, and the PR will not be a beneficiary of the pension assets the PR may not engage with the process.
9. **Identification of the PR:** PSAs will need guidance on how to identify the PR.
10. **Application of penalties:** HMRC has the discretion to apply penalties and, we understand, a requirement to apply interest at a penal rate where IHT is paid late. These already apply where IHT is due on an estate but in those circumstances the beneficiaries are defined either by the will or law. Where pension benefits are subject to discretion extra steps are required for the trustee to exercise that discretion properly and so a longer time period should apply before penalties are imposed.
11. **Asymmetry of interest:** The rate on which HMRC charge interest on underpaid / late IHT is higher than the rate on which HMRC pay a refund. This is not appropriate if the process is designed in such a way that amendments are highly likely, especially if IHT may have been overpaid in one area (pension or estate) and underpaid in the other.
12. **Interdependency:** A route to solving many of the practical issues raised would be to remove the interdependency in the IHT due between the estate and the benefits in each pension scheme. However, this would change the amount of tax due and from whom.