Integrity Asset Management

Integrity Asset Management
Willow House, Kestrel View,
Strathclyde Business Park,
Bellshill ML4 3PB

Tel: 01698 503860
Email: info@integrityasset.uk

A new era for pension inheritance

The inevitable shift in the approach to intergenerational wealth transfer

Pension savers intending to pass on their retirement funds to loved ones received unwelcome news following announcements in the 2024 Budget. The Chancellor revealed that pensions will soon be subject to Inheritance Tax (IHT), marking a significant change from previous rules that usually protected pension funds from tax upon death.

Although the tax-free lump sum and pension tax relief remain unaffected, the government confirmed that unused defined contribution pension funds and death benefits paid from a pension will be included in a person's estate for IHT purposes. This change will take effect from 6 April 2027, meaning children inheriting their parents' pension savings could face a significant tax bill that was previously avoidable.

UNDERSTANDING THE NEW TAX LANDSCAPE

When you die, IHT is charged on the value of your assets above a certain threshold. This IHT threshold, known as the 'nil rate band', is currently set at £325,000, and any assets exceeding this amount are liable to a 40% tax charge. The threshold has been frozen at this level since 2009, and Chancellor Rachel Reeves announced in the Budget that it will remain at £325,000 until April 2030, causing more families to fall into the tax net as asset values rise.

If you are married or have a registered civil partner, you can currently leave your entire estate to your spouse or partner free of IHT. Under current rules, your pension usually isn't counted as part of your taxable estate on death. From April 2027, unused pension funds and certain death benefits will be brought into scope for IHT, meaning they may form part of your estate for tax purposes.

IMPACT ON UNMARRIED PARTNERS AND BENEFICIARIES

The pension pots targeted by these new proposals include both defined contribution benefits paid as income to dependants through an annuity or drawdown, and defined benefit pension lump sum death benefits. Careful implementation and clarity will be essential, particularly for unmarried partners who may be at a disadvantage compared to their married counterparts.

Because the IHT spousal exemption allows married couples and registered civil partners to pass their estates to their spouses without tax, benefits paid to an unmarried partner may face IHT charges. Now that pensions are set to fall within the scope of IHT, surviving unmarried partners could end up with considerably less income and, consequently, a lower standard of living in retirement.

ADMINISTRATION AND STRATEGIC SHIFTS

According to the Treasury, pension scheme administrators (PSAs) will be responsible for reporting and paying any IHT due on unused pension funds and death benefits. Including pensions in the IHT net is likely to encourage many savers to consider alternative ways of passing on their wealth without facing a significant tax bill.

The long-standing practice of shielding pensions from IHT has been a key element of retirement planning; removing this benefit will inevitably alter the approach to intergenerational wealth transfer. We might see more pensioners inclined to draw down their pension funds during their lifetime rather than leaving them as inheritance.

RETHINKING YOUR FINANCIAL FUTURE

This change could direct attention towards other tax-efficient savings options, such as Individual Savings Accounts (ISAs). While ISAs offer tax-efficient growth and withdrawals, pensions still provide immediate tax relief on contributions and may include employer contributions. However, their appeal as a method of passing on wealth might be diminished by these new factors, encouraging some savers to make more generous gifts during their lifetime.

Gifts benefit from the 'seven-year rule', meaning if a gift is made more than seven years before a donor's death, no IHT is payable. There are also several other gift allowances available that haven't been affected by the Budget. While the changes are significant, avoid making panic decisions. It is worth noting that estate planning and determining the best way to manage your pension can be complex, and professional advice is often the safest approach. ■

TIME TO FIND OUT HOW TO PROTECT YOUR ASSETS FOR YOUR BENEFICIARIES?

Navigating these new rules requires careful planning to safeguard your assets for your beneficiaries. We can assist with your unique circumstances if you want more information on how this may impact you. Feel free to contact us to discuss your situation.