TISA

ALTERNATIVE APPROACHES TO TAXING UNUSED PENSION WEALTH AT DEATH

A REPORT FOR TISA

EXECUTIVE SUMMARY

JULY 2025

Prepared by OXFORD ECONOMICS

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July 2025

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FOREWORD BY TISA

The treatment of unused pensions within the inheritance tax (IHT) framework is an issue that has garnered increasing attention in recent months. While both pensions and IHT are individually complex areas, the prospect of integrating them creates a significant challenge—one that risks introducing further complication, confusion, and unintended consequences for individuals, families, and professionals alike.

This paper outlines alternative solutions to the government's proposal to include unused pension funds within the value of a person's estate for IHT purposes. From the additional burden placed on personal representatives (PRs), many of whom are grieving family members, to the increased likelihood of errors, delays, and unintended tax liabilities, the issues span far beyond mere policy intent. Particularly concerning is the potential impact on individuals in vulnerable circumstances, many of whom may be forced to make rushed decisions under stress and within tight deadlines.

The interaction between pension scheme administrators (PSAs) and PRs would become far more intensive, constrained by time pressures and complex calculations around nil-rate bands and asset valuations. The implications are clear: longer delays in paying death benefits, greater risk of interest charges for late IHT payments, and the possibility of misallocation of entitlements due to outdated or binding nominations replacing flexible discretionary decisions. The appendix provides a more detailed breakdown of some of the key challenges and risks that the proposed IHT approach creates, along with the benefits of alternative models.

Moreover, there are broader behavioural concerns. Including unused pensions within IHT risks undermining long-standing efforts to promote sustainable retirement planning and responsible pension savings. It could prompt individuals to reconsider increasing pension contributions and draw down their pension savings prematurely, diminishing retirement adequacy and potentially increasing future reliance on state support.

While no solution is without its challenges, we recognise the government's focus on this area. The current proposals, however, risk delivering poor outcomes for consumers. In this paper, we outline alternative approaches that aim to achieve a more equitable and less detrimental outcome than the one currently under consideration. These alternative approaches maintain simplicity; ensure beneficiaries receive funds in a timely manner; leverage existing processes between HMRC and beneficiaries; and protect customers in vulnerable circumstances, while still delivering the intended fiscal objectives. Furthermore, we would like to emphasise that annuity death benefits and registered group life insurance (i.e. death in service payments) should remain outside the scope of the government's current pensions and IHT proposals. These benefits do not align with the policy's intended objectives, as they cannot be used as tax incentivised wealth savings vehicles and serve as an important financial lifeline for beneficiaries following the death of a loved one. As such, annuity death benefits nor death in service benefits are included in the analysis, and we strongly advocate for their exclusion from any future changes.

We hope this paper contributes meaningfully to the wider debate and encourages the exploration of balanced, practical solutions. We remain committed to working constructively with government to ensure any changes serve the best interests of consumers, the industry, and the public purse alike.

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The UK government has announced plans to bring unspent pension pots and death benefits into scope of inheritance tax (IHT) from April 2027. The Investing and Saving Alliance (TISA) has commissioned Oxford Economics to estimate the fiscal impacts of two alternative policy proposals designed to improve outcomes for pension scheme members, beneficiaries and pension scheme administrators while raising the same level of tax revenues as the government's proposal.

- Under **Proposal 1**, inherited pension pots and DB lump sum death benefits[1] can only be taken as taxable income over time if the beneficiary is a dependant. If the beneficiary is not a dependant, then they must take the full pension value as a lump sum paying income tax at their marginal rate. There is no difference in income tax based on the age at which an individual dies and the tax only applies where the deceased's remaining unused fund exceeds £90,000.
- Under **Proposal 2**, a standalone flat rate "inheritable pension tax charge" is paid on all unused pension funds and DB lump sum death benefits above a threshold. Each deceased individual has their own threshold and there is no spousal exemption. Separately, the income tax treatment of pensions based on age remains unchanged with pension wealth being tax-free when the deceased is under the age of 75 and taxed at the recipient's marginal rate when the deceased is over the age of 75. Three combinations of threshold and flat rates have been modelled for this proposal—Option A (25% rate and £150,000 threshold); Option B (30% rate and £200,000 threshold); and Option C (35% rate and £250,000 threshold).

The mechanism for collection of the tax would mirror the existing process for collection of death benefits which exceed the LSDBA i.e. the Personal Representative would liaise with HMRC to determine and arrange collection of any tax due from beneficiaries.

Prior to assessing the fiscal impact of the alternative proposals, the modelling framework **was tested against outturn IHT receipts data as well as the OBR's forecasts for IHT receipts**. The model performed well against these tests providing confidence in the robustness of our analytical framework.

Our modelling suggests that **the government's policy will raise £1.3 billion in additional IHT revenues in the first year** following implementation compared to the OBR's £1.1 billion estimate. In the following years **revenues from the government's proposal increase in both forecasts to exceed £2.0 billion**.

Our modelling shows that **revenues raised through the alternative policies aligned closely with revenues raised by the government's proposal**. The difference in revenue between the alternative proposals and the government's proposal never exceeds £40 million in any year of the forecast. This demonstrates the scope to move to alternative policy options with minimal impact on the public finances.

This analysis **focuses on the fiscal impact of the alternative proposals** relative to the government's plans. It does not consider the impact these policies may have on pension savings behaviour, how the policies would affect different types of beneficiaries across the income spectrum, or the practicalities of implementation.

[1] Annuity death benefits and registered life assurance schemes not captured in the modelling for either proposal.

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