FAQs

Questions:

1. **Government estimates in the technical consultation that 1.5% of UK estates would become liable to pay Inheritance Tax where this would not previously have been the case. If the expected impact is this minimal, why is it necessary to put forward alternative proposals?**

- Whilst only a small % will actually end up paying IHT, this will impact every pension scheme member, irrespective of the size of the pension pot. Everyone will need to go through the convoluted process before pension scheme administrators can pay out the full beneficiary entitlement with a degree of confidence that it's correct. So all pension death claims will be delayed, potentially significantly at a time when beneficiaries are likely to be in a vulnerable state.

- The discretion that pension schemes have in paying out death benefits means that the process can already take time to finalise where complex family scenarios exist. The additional steps required will almost certainly mean that significant percentage of death claims where IHT is due will exceed the 6 month timeline, resulting in pension pots being eroded through the payment of interest to HMRC. This also means there is likely to be a significant delay before HMRC receive any IHT payment due from a pension scheme.

- Whilst consumers do not typically have high levels of financial literacy, bringing pensions into the scope of IHT is likely to change the behavioural habits for some cohorts which undermine the adequacy challenge we are collectively trying to address. Scheme members may not be able to save with the certainty that their pension pot on death will be or won't be caught by an IHT charge – it is effectively penalising consumers for doing the right thing. It is already anecdotally resulting in some drawing down their pension at a faster rate to avoid an IHT charge at a later date. This could result in pots being extinguished early, retirement lifestyles compromised and a greater reliance placed on state benefits.

- Pension savings are different from other forms as the value has, in part and potentially significantly been funded by the Government through tax relief. This tax relief is provided with an expectation that pension benefits will be taken at a later date, which will be subject to PAYE. It is therefore, entirely appropriate to have a separate tax regime for pensions to reflect this important difference.

- The scope of which unused pension assets will be caught by the proposals is currently unknown. As such, it is unclear how the 1.5% has been reached. However, we would expect with the shift from DB to DC and the ongoing work to increase levels of pension adequacy, the number of estates impacted is likely to grow over time.

- Government have set an objective to cut the administrative burden for industry by 25% by the end of this parliamentary term. The IHT proposals do not support that objective and actually conflict with it. Our alternative proposals are more aligned to this objective.

2. We have heard and it is detailed in the report that the practical impact of bringing unused pensions into the cope of IHT will be significant. How will the proposals simplify things and for who?

- Simplicity for members and beneficiaries - communicating a charge which is solely based on the size of the remaining pension fund, potentially alongside a certain level of tax-free element, is much simpler. It means that scheme members can save with confidence, knowing exactly what the tax treatment of their pension would be on death. Paying benefits quickly and outside the IHT environment will also avoid any additional costs falling on beneficiaries – such as late payment interest. It will also be simpler for advisers, who are currently faced with significant challenges due to the uncertain nature of whether a tax charge will be due.

- Quicker payment and lower costs for beneficiaries and schemes - schemes would not have to rely on the speed of other schemes or the Personal Representatives in making payments – they could do so quickly and easily. This greatly simplifies the process and administrative burden falling on schemes. Remembering that any increase in costs which schemes experience will, over time, likely be passed to consumers.

- Benefits for HMRC - using one of the alternative approaches will allow schemes or beneficiaries to pay tax to HMRC quickly and easily using established processes already put in place by HMRC for industry to use – the LSDBA reporting process This will mean HMRC receive tax much more quickly and it is much more likely to be an accurate amount. There will also be little, or no reconciliation required at HMRC reducing work and costs.

  Lower level detail for each proposal is contained within the report.

3. Won't this mean more people will pay a pensions tax charge than under the IHT proposals?

- We need to recognise that no solution here is perfect. They all represent what is potentially a worse outcome for consumers than what we have now, however we understand the government's focus on this area and are keen to present alternative solutions that result in a fairer and less damaging outcome to the proposal that is on the table.

- This may increase the amount of tax some beneficiaries will pay, but it may reduce it too. The distributional impacts of the proposals will have to be worked through, and it will very much depend on the threshold level. However, it's worth noting that we argue (and modelled) for death in service benefits to be exempt as there is no obvious intergenerational wealth transfer being planned for with such provision and will reduce the financial impact of untimely deaths to some degree.

- Both proposals include the provision of a nil rate band/threshold, which will protect, to some degree lower paid and vulnerable scheme members. Set at a reasonable level before a tax charge will become due will mean that there will be money available to pay any tax charge. The likelihood that beneficiaries will have spent more than the nil rate band let alone the taxable element above it may be extremely unlikely in practice (give the level of the band proposed). We also propose that disclosure to beneficiaries would highlight the process and where they may be due tax to pay to HMRC. We think this manages the perceived risk appropriately and is significantly more streamlined than the probate process.
- The certainty that this tax would provide means that over time, people can plan accordingly and align their pension savings to the level of tax that they want to pay. This may also mean planning to stay under the nil rate threshold to avoid tax altogether where this is appropriate based on circumstances.
- It is worth remembering that the taxation of pension death benefits between 2006 and 2015 were more widely applied than the current government proposal and unused pension pots on death will have been funded in part, potentially significantly through tax relief. Other savings will not have had this government top up.

4. One of the unknown areas is the scope of the change and whether it will impact death in service benefits. How has that been considered in the research and what are your thoughts on whether it should be included in additional taxation?

- The potential inclusion of products such as Group Death in Service (DIS) extends the scope beyond pensions and the original policy intent, as well as creating the need for a different process. These benefits cannot be used to accrue wealth and use as wealth transfer vehicles and would also bring into scope individuals who have not even reached Normal Minimum Pension Age (NMPA). Additionally, the main purpose of DIS is to protect the immediate financial future of a family who loses a working age earner, providing quick access to funds without the need for probate or a lengthy process to determine the funds payable. Based on current proposals, this group would also be expecting a lengthy delay in receiving any death benefits from unused pensions., compounding matters during their period of bereavement. This is a crucial factor which need to be taken into consideration when deciding on the scope of these proposals.