

# Keeping it Brief

## Inheritance tax and your pension

**From 6 April 2027, significant changes to how inheritance tax applies to pensions will come into effect. Here we explain the current position and how this will change.**

### How does inheritance tax work?

Inheritance tax (IHT) is paid on the value of a person's estate (broadly property, savings, investments, possessions) when they die. There's normally no IHT to pay if the value of your estate is less than the tax-free threshold of £325,000, or you leave everything above the threshold to your spouse, civil partner, a charity or community amateur club.

If you pass on your main home to your children or grandchildren, your individual threshold can rise by up to £175,000 to a total of £500,000, as long as your estate is worth less than £2 million. If you're married or in a civil partnership, any unused threshold can be transferred to a surviving partner when you die. This means a couple could potentially leave an estate worth up to £1 million tax-free.

The standard IHT rate is 40% which is only charged on the part of your estate that's above your IHT threshold. This rate could drop to 36% if you give 10% or more of your net estate to charity.

### What currently happens to your pension when you die?

Currently, pensions are generally not included when working out the total value of an estate for IHT purposes. Changes in pensions legislation in recent years means it is now possible to build up unlimited pension savings which can be inherited IHT free. This was never the intended purpose of a pension, which was designed to be a tax-efficient means of providing a retirement income during an individual's lifetime.

### What's changing

From 6 April 2027, most pension savings will be added to the value of your estate to determine if IHT is payable unless they are paid to a surviving spouse or civil partner (these will remain exempt from IHT like any other assets). This includes:

- defined contribution pension pots (for example group personal pension plans)
- income or lump sum amounts paid under a guarantee, such as an annuity that guarantees to pay the remaining benefits to your chosen beneficiary if you die during a certain period
- certain other death lump sums such as refunds of contributions

Death in service lump sum benefits (typically set up as a multiple of salary by your employer) will not be affected and will remain exempt from IHT. This is because these benefits are not intended as a tax planning tool, but as a form of financial protection for families during times of loss.

It's also worth noting the following:

#### **Potential double taxation on inherited pensions**

Under current rules, if an individual dies aged 75 or over, their beneficiaries will pay income tax on any pensions they inherit at their personal rate. These rules will continue to apply, which means that beneficiaries could face both IHT and income tax on the inherited funds.

### **Differential treatment between unmarried partners and spouses/civil partners**

The changes emphasise differences in treatment, with IHT exemptions for spouses/civil partners but not for unmarried partners. If your pension savings are paid to your spouse or civil partner, there are no IHT consequences. But if they are paid to your unmarried partner, they will be included in your estate for IHT purposes.

### **How will it work?**

The people responsible for managing your estate - known as personal representatives (PRs) - will be in charge of reporting and paying any IHT due.

Once the beneficiaries are identified, they'll become jointly responsible for paying any IHT due on the pension benefits they will inherit. Pension beneficiaries may be able to ask the pension scheme administrator to pay the IHT directly to HMRC.

Any IHT due must be paid by the end of the sixth month following the date of death. If not HMRC will charge interest at a rate of 4% plus Bank of England base rate.

### **How will the changes affect you?**

The changes will primarily impact those with very large pension pots and estates. The vast majority of estates currently don't pay IHT and this is expected to continue after the new rules take effect.

If you think you are likely to be affected, there are various ways to minimise the impact of IHT on your pension savings. It's really important to understand the implications of each option to determine what best suits your individual circumstances, and you should consider taking personalised financial advice before making any decisions.

It's also worth checking who your pension beneficiaries are and making sure your wishes are up to date.

#### **Please note:**

This briefing note gives an overview only, it does not provide specific advice. It is based on our understanding of tax regulations for the 2026/27 tax year which may change in the future.

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