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UK Pensions Briefing: Budget October 2024

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What's changed?

- Inheritance Tax (IHT) payable on unused DC pots and lump sum death benefits from DB schemes.
- Gibraltar and EEA exemption removed from overseas transfer charge.
- Employers' NICs increased from 13.1 per cent to 15 per cent; reduction in threshold from £9,100 to £5,000.

What's staying the same?

- State pension triple lock maintained.
- IHT nil-rate band frozen at £325,000.
- Annual allowance unchanged at £60,000.
- 25 per cent tax free cash unchanged.
- Tax relief on contributions maintained at savers' marginal rates.
- Freeze on income tax thresholds remains until April 2028.

As usual in the run-up to a financial statement from the Government, there were many pensions rumours circulating before the Autumn Budget on October 30, 2024 (Budget Day). Tax-free lump sums, tax relief on members' contributions and the level of the annual allowance were all seen as possible targets for the Chancellor. In the event, none of these speculative reforms were introduced. Of all the rumoured pensions tax changes, the future application of inheritance tax to unused pension funds and death benefits is arguably the least disruptive, though clearly it could have a material impact on estate-planning for those wishing to leave inheritance to loved ones. In this briefing we look at the detail published so far on the pensions IHT changes, together with the other minor pensions tax adjustments announced by Rachel Reeves.

Changes to the inheritance tax on pensions

With effect from April 6, 2027, inheritance tax will apply to benefits from all UK registered schemes and Qualifying Non-UK Pension Schemes.

IHT will be applied to unused DC pension pots and also to lump sum death benefits, including those from DB schemes. This policy is designed to remove the incentive to use pension funds as a means of estate-planning, where retired savers spend other funds as income first (such as ISAs) before dipping into their pensions. Currently, unused DC pots are outside the scope of IHT, as are lump-sum death benefits from a DB scheme. After a member's death, trustees pay lump sums at their discretion taking into account the member's nominations in their expression of wish form. As the members' nominations are not binding on the trustees, the lump sum falls outside the member's estate. From 2027, benefits after death in private sector occupational schemes will be brought into line with some non-discretionary public sector schemes and IHT will apply.

The consultation paper published on Budget Day covers the liability, reporting and payment process for the IHT that arises, and the most recent edition of HMRC's Pension schemes newsletter (164) summarises the changes. IHT will also affect other sums paid from occupational DB schemes, such as pension protection lump sum death benefits and trivial commutation lump sum death benefits. Annex B to the consultation sets out all types of benefits affected. The only exceptions are a dependant's scheme pension and a charity lump sum death benefit. Scheme administrators will be responsible for paying the IHT due on the pension benefits before they are paid out to beneficiaries. In addition, where a member dies over age 75, income tax may be payable at the recipient's marginal rate on the sum received net of IHT from the scheme.

The new arrangement will require close liaison and information sharing between pension scheme administrators or trustees, the deceased member's personal representatives, beneficiaries and HMRC. The process set out in the consultation appears complex with the IHT nil-rate band being apportioned between different classes of assets, such as property, pensions and other holdings within the estate. Nonetheless, strict time limits will apply to the process and IHT is due within 6 months of the end of the month in which the death occurred. This is a tight deadline and will no doubt attract comment during the consultation process. Failure to meet this deadline will result in late-payment interest being applied on the IHT due.

The consultation paper states that *"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"*. It is unclear whether the changes apply to insured death in service benefits or payments from unregistered life assurance schemes.

The consultation period ends on January 22, 2025, following which further consultation will be conducted once the draft legislation is available.

Overseas transfers

Before the Budget, transfers to Qualifying Recognised Overseas Pension Schemes (QROPS) attracted a 25 per cent transfer charge. However, there was an exclusion for transfers to QROPS established in the European Economic Area or Gibraltar. This exclusion has been removed with effect from October 30, 2024, although it continues to apply to transfers requested before October 30, 2024, so long as the transfer is completed before April 30, 2025. The policy intention is to address the risk of individuals receiving double tax-free allowances on savings where UK tax relief has already been applied.

In addition from April 6, 2026, scheme administrators of schemes registered in the UK must be UK resident.

Comment

The application of IHT to pension benefits will mean a rethink before April 2027 on the tax-planning front for many individuals who had been intending to leave their funds as a largely tax-free benefit for their heirs. Administrators and financial advisers will have their work cut out in advising clients on the new tax implications for their pension savings. The end result is that many more estates will be brought into IHT scope and it will be important to see how the new IHT reporting and payment system will interact with different types of scheme.

The dramatic increase in NIC costs for employers could have a knock-on effect on salary sacrifice schemes as employers could choose to stop sharing NIC savings with employees. It is possible that the planned expansion to the auto-enrolment regime is further delayed, as the Government may consider it inappropriate to further increase employers' costs in the short term.

There is speculation that pensions tax relief may be considered in the ongoing Governmental Pensions Review. However, it is hoped that this particular change will not be implemented. Pensions cannot be accessed until age 55 (increasing to age 57 from April 6, 2028) and adequate incentives need to be maintained to encourage long-term saving across the earnings spectrum.