

Strictly Private & Confidential

Rt Hon Rachel Reeves
Chancellor of the Exchequer
His Majesty's Treasury
1 Horse Guards Road
London
SW1A 2HQ

22 November 2024

Dear Chancellor,

The most significant decision affecting retirees in the Budget was the announcement that unused pension pots will be subject to Inheritance Tax (IHT) from April 2027. Bringing pensions into IHT in the way proposed is arguably the most complex and costly way of raising tax from unused pensions on death.

I'm raising this issue not to disagree with the premise that unused pension funds should be taxed on death, but to ensure the method used to achieve this aim is workable and doesn't have unforeseen consequences. As the proposals currently stand, applying IHT to pensions will create delays for beneficiaries, will be costly and will prove unworkable in many situations. If the Government presses ahead with the proposals as written, it will risk fundamentally undermining the UK pensions system. There is a simpler solution that can achieve the same outcome for the Exchequer by utilising income tax rather than IHT, something that is already common in the pension market.

The current proposals will result in double taxation of unused pension funds – IHT and then income tax on the remaining funds. Unless there is unused IHT nil-rate band to utilise, a beneficiary paying the higher rate of income tax, and there are 6.3 million higher rate taxpayers in the UK¹, will face a minimum effective tax rate on the inherited pension of 64%. This could be much higher in some cases depending on the circumstances of individuals involved. Whilst the issues explained in this letter are relevant irrespective, the alternative proposals are put forward on the assumption that this double taxation is not the policy intention.

Why the IHT proposal is slow, costly and ultimately unworkable

First of all, the distribution of unused pension funds will slow to a glacial pace. Currently, unused pension funds can be distributed without waiting for probate. This will stop in all cases from April 2027, when all unused pension funds will go through probate. At what will be an emotionally challenging time for those close to the deceased, and for most of whom IHT will ultimately not apply, the process of distributing much needed support will end up stalled in a much more complicated probate process.

Under the proposed plan, pension schemes will be required to engage with the personal representative (PR) of the deceased scheme member to determine how much of their IHT nil-rate band should be apportioned to the scheme they administer. This process will be required regardless

¹ [Summary Statistics - GOV.UK](https://www.gov.uk)

of the size of the estate, the pension fund or whether the money will be passed to a spouse or civil partner. In addition to causing inevitable delays, this often unnecessary administration will raise costs for providers, which will ultimately be passed onto retirement savers through higher charges.

Settling IHT to be paid from the pension scheme within six months of the member's death – the time limit for gaining probate – will prove impossible in many cases for reasons out of the control of the pension scheme.

For example, over half of UK adults do not have a will², meaning even the seemingly simple task of identifying a PR will be challenging in large numbers of cases. Even where a PR exists, they will be faced with a new task of engaging with what will often prove to be multiple pension schemes (the average person in the UK has 11 jobs in their lifetime according to the Department for Work and Pensions³, with each potentially creating a new pension), each with differing instructions and processes. Where a PR is unaware a pension scheme exists or fails to contact the scheme in good time, delays will be inevitable.

All of those complexities arise before the PR begins the task of deciding how to apportion the nil-rate band to each pension scheme. This can only happen once the value of all other assets in the estate has been established, meaning the necessary back and forth with the scheme administrators to confirm the allocation of the nil-rate band will be one of the last things to happen.

All of this complexity will cause significant delays and additional costs, but as is often the case in financial services, it is liquidity that will prove to be the real stumbling block.

Pension funds holding illiquid assets – something the Government and the FCA are specifically trying to encourage through the creation of Long Term Asset Funds (LTAFs) and wider policy initiatives – will often struggle to sell these within a year, let alone six months. This is particularly the case where a pension is invested in commercial property, but also in a fund that is closed to redemptions as we have seen with a number of property funds and other cases like the Woodford Equity Income fund which has been frozen for over five years.

In short, completing this process in six months will not just be difficult, in many cases it will prove impossible.

A simpler alternative – applying income tax

Rather than pressing ahead trying to make IHT work, the Government should revisit the central question of, "What is the simplest and fairest way to raise money from unused pensions on death?".

The clear answer to that question is to apply income tax at the marginal rate of anyone not the spouse or civil partner of the deceased.

This would be both fair (as the highest earning beneficiaries would face the largest tax bills) and administratively straightforward because it follows the process already in place for people aged over 75. As a slight aside, that is an arbitrary age that is no longer required in the pension system and so should be removed.

Using existing income tax structures which are already familiar to pension firms (and for which systems have been built) would avoid unnecessarily extending the probate process and putting up pension fees for consumers.

This proposal would neatly deal with any liquidity issues, as the money and the associated tax would both be paid once the original asset had successfully been liquidated.

² <https://www.nationalwillregister.co.uk/news/two-fifths-of-uk-adults-not-discussed-instructions-after-death-new-wills-report-finds/>

³ [Thousands more make contact with long lost funds - GOV.UK](#)

Another option – replicate the ISA framework

If the Government is intent on bringing pensions into IHT, the simplest way to do this would be to follow a similar process to ISAs. Given ISAs already count towards people's estates for IHT purposes and are used by many people alongside pensions to fund their retirement, mirroring this approach as far as possible could be desirable. A system whereby unused pensions are simply paid to a spouse or civil partner IHT-free, or the estate where IHT is liable, would be much more straightforward than the convoluted process set out in the consultation.

As I said at the start of this letter, my focus is not the decision to raise tax from unused pensions on death, it is simply on making sure that the implementation does the minimum possible damage to the pension industry. At a time when the efficiency of the pension industry is a key focus for Government, the last thing we need is further complexity and there are simpler ways of achieving your desired outcome.

If you wish to discuss any of the above in further detail, please do not hesitate to contact me directly.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Michael Summersgill', with a stylized flourish at the end.

Michael Summersgill
CEO – AJ Bell plc