

HMRC's plans for Inheritance Tax (IHT) to apply on most pension benefits on death are now starting to take shape, following the publication of the [Finance \(No 2\) Bill](#) on 4 December 2025.

For this Aries Insight, we will look at what we know so far and how this area may develop going forward.

How did we get here?

It has been a long-standing principle that any lump sums payable on death under a pension scheme, where the recipient of a benefit is determined at the Trustees' / manager's discretion, do not form part of a deceased's estate and so are not subject to IHT.

Further, [Section 12 \(2ZA\)](#) of the Inheritance Tax Act 1984 has, since 6 April 2011, made it clear that any failure by a member to exercise their right to any pension benefits before death (as a result of which the value of the member's estate is reduced and the value of someone else's estate is increased) does not constitute a 'transfer of value' for IHT purposes, as so does not give rise to any possible IHT charge.

Following the introduction of 'pension freedoms' from 6 April 2015, [Section 12A](#) of the Inheritance Tax Act 1984 included further

provisions that served to exclude member's, dependent's nominee's and successors unused drawdown funds / flexi-access drawdown funds from any charge to IHT.

In the [Autumn 2024 Budget](#), however, the Government announced its intention to bring the majority of unused pension benefits on death within the scope of IHT from April 2027.

HMRC then [consulted](#) on how this might work in practice, although it is fair to say that the original proposals were not universally greeted with enthusiasm by the pensions industry.

HMRC also held a number of workshops with interested parties (including Aries) to discuss the proposals and consider alternative approaches to achieve the desired result, which has led to the provisions now contained in the [Finance \(No 2\) Bill](#) ('the Bill').

Aries Comment

It is of note that, where lump sum death benefits were not paid at the Trustees' / manager's discretion, then these have been considered to part of the deceased's estate and so potentially liable for IHT.

Many public sector pension schemes did not allow for any form of discretion, meaning that the tax treatment of benefits from such

schemes was different from the position for the majority of private sector schemes.

Part of the intention behind the new provisions appears to be to level the playing field here.

What are the current proposals: an outline

The changes proposed within the Bill will apply for deaths on or after 6 April 2027.

The Bill introduces a new concept of 'notional pension property' which is, broadly, the value of the benefits to be paid on the death of a scheme member (see the more detailed analysis below). This notional pension property is taken into account when assessing the value of the deceased member's estate for IHT purposes and may thus be subject to a charge to IHT.

Various benefits that are excluded from the notional pension property. These are as follows:

- dependants' scheme pensions;
- Trivial Commutation Lump Sum Death Benefits in respect of a dependants' scheme pension;

- a dependants' annuity, or a nominees' annuity, that was purchased as part of a joint life annuity; and
- any amount that is payable only because the member was an active member of the scheme and s in employment or other work of a particular description, immediately before their death (i.e. a death in service benefit).

The existing IHT exemptions in respect of transfers to the member's spouse or civil partner and to a charity will also continue to apply.

Primary liability for any IHT charge arising on the notional pension property remains with the deceased's Legal Personal Representative ('LPR') and the beneficiary, however the Scheme Administrator can also become liable in two specific circumstances (see below).

Where the LPR considers that a charge to IHT may arise on the notional pension property, they can serve a 'withholding notice' on the Scheme Administrator. Whilst such a notice is in force (see below) the Scheme Administrator must not pay more than 50% of the benefits due to a particular beneficiary, unless that benefit is excluded from the notional pension property.

The LPR or the beneficiary can require the Scheme Administrator to pay the IHT due on

the notional pension property (see below for more details), in which case the Scheme Administrator must pay that tax charge within 35 days.

A Deeper Dive Part 1: Valuing the Notional Pension Property

The pension scheme will be expected to determine the value of the notional pension property under the scheme (discounting any excluded benefit).

For a money purchase arrangement, this is the sum of the value of:

- any property (i.e. funds) held in a 'pension pot' that may or must be used to provide benefits under the arrangement on the death of the member; and
- any property (i.e. funds) that is not held in a 'pension pot' that may be and can reasonably be expected to be used to provide benefits under the arrangement on the death of the member.

(This second provision appears to be relevant for Collective Money Purchase arrangements, where there may not be a specific pension pot holding funds in respect of the particular member.)

For a defined benefit arrangement, the value of the notional pension property includes:

- the amount of any benefit that must be paid as a lump sum death benefit under the arrangement on the death of the member;
- the amount of any benefit not within the first point above that may be and can reasonably be expected to be paid as a lump sum death benefit under the arrangement on the death of the member; and
- the amount of any benefit that may be and, assuming that the maximum amount possible is paid as a lump sum death benefit, can reasonably be expected to be paid as a 'scheme continuation payment' under the arrangement on the death of the member.

(A 'scheme continuation payment' here means ongoing pension payments that are made after the member's death under any guarantee period.)

Where the Bill refers to any benefits that "... can reasonably be expected ...", if there is a question as to what would be reasonably expected, this should be determined with regard to appropriate actuarial assumptions.

Aries Comment

Whilst it is not addressed in the Bill, it seems clear that the scheme will be required to notify the LPR of the value of the notional pension property.

A Deeper Dive Part 2: The Withholding Notice

As mentioned above, the LPR can serve a withholding notice ('a notice') on the Scheme Administrator where the LPR knows that they are, or have reason to believe that they may be, liable for tax attributable to notional pension property of the deceased in relation to the scheme.

A notice takes effect from the point that it is received and expires on the earliest of:

- the date on which the LPR withdraws the notice; or
- when all the tax attributable to notional pension property of the deceased in relation to the scheme, and any interest due in respect of that tax, is paid; or
- 15 months after the end of the month in which the deceased died.

Whilst the notice is in force, the scheme must not pay out more than 50% of any benefit (other than an excluded benefit or a benefit due to a charity or a registered club) in respect of any particular beneficiary.

The payment of any benefit that would have been due except for the notice becomes payable when the notice ceases to have effect.

There will be a Scheme Rules override to provide that any Rule that requires a benefit to be paid in breach of the withholding requirement will be deemed to be void.

If a scheme pays out a benefit in excess of the 50% limit whilst a notice is in force, the Scheme Administrator becomes jointly liable for IHT due. (As drafted, this appears to apply for all of the IHT due on the notional pension property in the scheme, not just the benefits in respect of the beneficiary for whom the 50% limit was breached.)

Regulations will specify the form and content of a notice.

Aries Comment

Whilst the Bill says that the LPR should only serve a notice if they know or believe that a IHT charge may be due on the notional pension property, is it possible that the LPR will serve a notice in any event, on a 'just in case' basis, thereby frustrating a pension scheme's ability to settle any affected death benefits in a timely manner even when there is no likelihood of an IHT charge becoming due?

Conversely, as the notice only takes effect when it is received, will schemes try to settle the benefits due as quickly as possible, to get them paid before any notice is served?

Whilst there is no prescribed deadline for the submission of a notice, the fact that the notice expires 15 months after the end of the month in which the deceased died sets an effective deadline here,

A Deeper Dive Part 3: Instructing the Scheme Administrator to pay the IHT

As mentioned above both the LPR and the beneficiary can require the Scheme Administrator to pay the IHT due (and any interest due on that tax) on the notional pension property.

This is subject to:

- the notice specifying the amount that the Scheme Administrator is required to pay;
- that amount being at least £1,000; and
- the amount not exceeding the amount that the notice giver is liable for in respect of notional pension property under the scheme.

Notice from Beneficiary

Where the beneficiary provides such a notice, the specified amount must not exceed the difference between:

- the amount of the benefits payable to the beneficiary under the scheme on the deceased's death; and
- the amount that has already been paid on the deceased's death in benefits to or for the benefit of the beneficiary under the scheme, or that has already been specified in a payment notice given by the beneficiary in relation to the deceased.

Note that:

- the scheme's maximum liability here is limited to the value of the benefits still held under the scheme for the beneficiary; and
- the reference to an amount 'that has already been specified in a payment notice given by the beneficiary' indicates that a particular beneficiary can serve more than one notice on the scheme.

Notice from LPR

Where the LPR provides such a notice, the specified amount must not exceed the difference between:

- the amount of the benefits payable under the scheme on the deceased's death; and
- the amount that has already been paid on the deceased's death in benefits under the scheme, or that has already been specified in a payment notice given by any person in relation to the deceased.

Note that:

- the scheme's maximum liability here is limited to the value of the benefits still held under the scheme in respect of the deceased member; and
- the reference to an amount 'that has already been specified in a payment notice given by any person' again indicates that more than one notice can be on the scheme.

Regulations will specify the form and content of a payment notice.

A Deeper Dive Part 4: Scheme Administrator paying the IHT required (the 'Direct Payment Scheme')

On receipt of a payment notice, the scheme must pay the tax required within 35 days. It is expected that this will be paid via the Managing Pension Schemes Service.

The taxpayer (the beneficiary or the LPR) can, however, withdraw the payment notice within the 35 day period (if the scheme has not yet paid the tax due).

On paying the tax required, the scheme can then make a consequential adjustment to:

- where the payment notice was provided by a beneficiary, the benefits payable to that beneficiary under the scheme on the member's death; or
- where the payment notice was provided by the LPR, to any benefit payable under the scheme on the member's death.

Any such adjustment to the benefits must be made 'on a basis that is just and reasonable having regard to appropriate actuarial assumptions'.

There will be a Scheme Rules override to ensure that any provisions in the Rules that would prohibit or restrict:

- the payment of tax by the Scheme Administrator as required under the payment notice; or
- the consequential adjustment to a benefit payable under the scheme,

will be void.

Where the Scheme Administrator fails to pay the tax due under a payment notice within the deadline, the Scheme Administrator becomes jointly liable for IHT (and any interest) due. In this case, that liability is limited to the amount of tax that they have failed to pay as required under the payment notice.

Note that, if there is any overpayment of IHT here, any subsequent refund of the overpaid amount will **not** be made to the Scheme Administrator. Instead, it will be made to:

- the deceased's LPR; or
- any of the beneficiaries to whom HMRC considers the overpayment of tax to relate.

The Bill makes various provisions in respect to the taxation position on any refund, however that is outside of the scope of this Insight.

Aries Comment

Whilst not specifically covered in the Bill, it seems likely that the Scheme Administrator will have to notify the beneficiary or LPR when the tax due has been paid.

*The fact that any refund will **not** be made to the Scheme Administrator is good news. The scheme will not find itself dealing with any subsequent benefit adjustments that might arise if the refund were to be paid to the scheme.*

A Deeper Dive Part 5: When Does the Scheme Administrator Become Jointly Liable for the IHT?

As covered above, the Scheme Administrator only becomes jointly liable for the IHT due if:

- the scheme pays out a benefit in excess of the 50% limit whilst a withholding notice is in force; or
- the Scheme Administrator fails to pay the tax due under a payment notice within the 35 day deadline.

It seems likely that, in either of these situations, HMRC will indeed pursue the scheme for the tax due.

A Deeper Dive Part 6: 'Late' Discovered Benefits and LPR Discharges

There is always a risk that a pension benefit in respect of a deceased member is identified 'late' – that is to say after the LPR thought that all benefits and IHT charges had been accounted for.

The Bill includes provisions covering this possibility under which, in line with the existing [provisions](#) that allow the LPR to apply to HMRC for a Certificate of Discharge:

- if such a Certificate is given; and

- a further pension benefit (i.e. more notional pension property) is subsequently identified,

then the LPR is not liable for any further IHT that may be due, unless the failure to disclose the extra notional pension property when applying for the Certificate was a result of carelessness on the LPR's behalf.

Note that this would not, however, discharge the beneficiary of the extra notional pension property from any possible IHT liability (who may then be able to serve a payment notice on the scheme holding the extra notional pension property).

What can we expect going forward?

Having already moved very far from the original suggestions, it seems unlikely that HMRC will be making any major changes to the current proposals.

The Bill already includes a provision to ensure that payments of IHT by the scheme will be authorised payments under the Finance Act 2004.

There will have to be changes to Regulations (presumably The Registered Pension Schemes (Provision of Information) Regulations 2006 [[SI 2006 / 567](#)]) to support the information flow

that will be required between the scheme and the LPR / beneficiary.

We can also expect further detail to be provided in future Pension Schemes Newsletters.

One particular area of concern that has already been identified is where, particularly on death before retirement, a money purchase arrangement will be using any part of the member's pension pot to purchase an annuity for a dependant or other beneficiary (other than the spouse / civil partner) and the scheme purchases that annuity before any payment notice is received.

In this situation, the annuity purchase price will form part of the member's pension pot and may give rise to a charge to IHT on the beneficiary (unless this is the member's spouse or civil partner) and the scheme will have already used the funds in question, so cannot subsequently be served with a payment notice in respect of the purchase price.

This could leave the beneficiary facing a large IHT charge without any scope to require the scheme to pay that charge.

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