



Changes to Inheritance Tax on Pensions

30th October 2025

Since the 1986 Finance Act, pensions have generally fallen outside of an individual's estate for Inheritance Tax. This led to pensions being an attractive place to save for future generations. From 6th April 2027 this will no longer be the case, and many estates will be subject to inheritance tax as a direct consequence of including pensions in the calculation.

In the Autumn Budget last October, even more than in previous years, there was significant speculation that the Chancellor Rachel Reeves would target the pension tax-free cash rules.

Although the existing rules on tax-free cash were left unchanged, pensions did not escape the last Budget unscathed.

On 30th October 2024, Reeves announced that unused pension capital would be included in an individual's estate for Inheritance Tax (IHT) purposes from 6th April 2027 onwards.

In general terms, if an individual's total estate (including unused pension funds) exceeds their nil-rate band (presently £325,000), IHT will now be payable on the excess at the rate of 40%.

There will be some exclusions, as detailed below:

- The spousal exemption will still apply. This means that pension funds can be left to a surviving spouse with no IHT consequences.
- Defined benefit pensions and death in service payments will not be included in IHT calculations.
- In most cases, ongoing annuity payments on death will not be included for IHT purposes.

Naturally, including unused pension funds in the taxable estate will increase IHT receipts. This change is expected to raise about £640m for the exchequer in 2027-28, rising to £1.34bn in 2028-29 and £1.46bn the following year.

According to the latest estimates, approximately 10,500 additional estates (around 1.5% of total UK deaths) will become liable for IHT in 2027-28 tax year due to the inclusion of pensions within the IHT calculation.

In addition, it is estimated that 38,500 estates will now pay more Inheritance Tax than they would have previously due to the inclusion of pensions within the estate.

When combined with the extended freeze of the nil-rate band until April 2030 (also announced in last year's Autumn Budget), it is likely that an increasing number of estates will be subject to IHT going forwards.

Income tax

Since 6th April 2015, the age at which an individual passes away determines how much Income Tax is paid when beneficiaries withdraw inherited pension benefits.

Generally, if an individual passes away before the age of 75, pension benefits can be withdrawn by beneficiaries free of all taxes.

On the other hand, for individuals who depart this life aged 75 or older, inherited pension benefits are subject to income tax at the beneficiary's marginal income tax rate upon withdrawal.

In recent months, the government has clarified that the age 75 rule will continue to apply after 6th April 2027.

Considering the above, some inherited pension benefits will now be subject to double taxation when an individual passes away after age 75, as depicted below:

	Present legislation		Post 6 th April 2027	
	Death age 74	Death age 75	Death age 74	Death age 75
Inherited pension (gross)	£500,000	£500,000	£500,000	£500,000
IHT payable	£0	£0	£200,000 ¹	£200,000 ¹
Income tax payable ²	£0	£100,000 ²	£0	£60,000 ²
Inherited pension (net)	£500,000	£400,000	£300,000	£240,000

1. Assuming IHT nil-rate band is already used.

2. Assuming basic rate income tax (20%) is applied.

As shown above, a basic-rate taxpayer withdrawing inherited pension benefits where the full value of the fund was subject to IHT and the member passed away after age 75 will be subject to an effective tax rate of 52% after the changes come into effect.

This marks an increase of 160% in the amount of tax paid when compared with present legislation, where only 20% income tax is payable on withdrawal of benefits.

The amount of tax payable is heightened if the recipient is a higher or additional rate taxpayer. In extreme cases, an effective tax rate of 84% can be applied to inherited pensions upon withdrawal.

For some, inheritance tax is not a concern. For others, however, it is a priority and depending on your circumstances, it may be possible to limit the IHT payable on your estate through careful financial planning.

Generally, this will begin with a full review of the estate value (including pension funds) and any Expression of Wishes which is in place.

An Expression of Wishes is used to nominate the beneficiary(s) the member wishes to receive any unused pension funds on death, but it also determines the options and flexibility those beneficiaries will have.

In some scenarios, a beneficiary may be able to avoid receiving a large (taxable) lump sum from your pension and instead, could keep it invested within a tax free fund.

Summary and conclusion

The forthcoming changes represent one of the most significant changes to pension taxation for decades.

While pensions have previously been viewed as a highly tax-efficient vehicle for passing on wealth to the next generation, the inclusion of unused pension funds within the IHT calculation from 6th April 2027 will fundamentally alter that landscape.

Furthermore, the interaction between Inheritance Tax and Income Tax (particularly for those who have reached the age of 75) introduces additional complexity and the potential for considerable tax charges on the death benefits paid from pensions.

With this in mind, it is increasingly important to assess how pensions fit within the broader estate and if appropriate, to take steps to manage or mitigate the impact of the upcoming changes. As always, taking individual advice suited to your needs and objectives is recommended.

If further advice on this subject or any other aspect of your financial planning will be welcome, please do [contact us](#) and we will be delighted to help.

Ryan Carmedy, Associate IFA
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