United Kingdom: Autumn Budget 2024 – What are the pensions implications?

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Pension scheme taxation | Occupational pension schemes | Budget 2024 | IHT | Inheritance Tax

In brief

Despite widespread speculation, the Autumn Budget did not introduce pensions taxation reform on the scale that had been anticipated. The new Government did, however, significantly extend the range of pension death benefits that will become subject to Inheritance Tax (IHT) on a member's death, with the changes coming in from April 2027. Other Budget announcements such as the increase in the rate of employers' National Insurance Contributions (NICs), may also have a "knock-on" effect on employers' pension provision in the future.

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Further detail

What happened?

In summary, the Government announced the following main pensions changes in the Budget:

- From April 2027, IHT will be applied to "unspent" pension pots and death benefits within registered pension arrangements. According to the Government, this change was introduced to reflect the Government's policy aim that pensions should not be a vehicle for the accumulation of capital funds for the purposes of inheritance. Please see more below on this development.
- The previous exclusion from the Overseas Transfer Charge (OTC) for transfers to "Qualifying Recognised Overseas Pension Schemes" (QROPS) in the European Economic Area or Gibraltar was removed with effect from 30 October 2024. This change is designed to address the risk of individuals receiving double tax-free allowances from a UK

registered pension scheme to a QROPS and on certain onward transfers between QROPS. The OTC is intended to target those seeking to reduce their tax liabilities by moving their pension savings to another jurisdiction.
- The conditions relating to Overseas Pension Schemes and Recognised Overseas Pension Schemes established in the EEA will be aligned with similar schemes established in the rest of the world from 6 April 2025.
- The government will also require scheme administrators of registered pension schemes to be UK resident from 6 April 2026.

The full Autumn Budget can be found here.

What did not happen?

There was widespread speculation that more fundamental pension reforms would be announced in the Budget than ultimately proved to be the case. Mooted possible reforms included changes to pensions tax relief (for example, the introduction of flat rate tax relief on member pension contributions), the limiting or removing of tax-free cash lumps sums and the removal of the NICs exemption on employer pension contributions.

IHT pension changes

As noted above, IHT reforms were the only material Budget change to affect pension arrangements. The Budget documentation referred only to changes to "death benefits" for IHT purposes from 6 April 2027. However, the scope of the changes has been clarified in a separate HMRC technical consultation relating to the processes that will govern the reporting and payment of IHT on pension death benefits. Significantly, the changes impact both defined contribution (DC) plans and lump sums payable from defined benefit (DB) arrangements.

A number of nil rate bands, exemptions and reliefs which currently operate in relation to IHT will continue to apply. For example, the current nil rate band allows estates to pass on at least GBP 325,000 to beneficiaries without incurring IHT. The Government has been clear that the current spousal IHT exemption that applies on transfers on death to spouses or civil partners will not be affected by the proposed changes. This suggests that any death benefit payment to a spouse or civil partner would not attract any IHT liability, even after April 2027.

What's in and what's out?

The technical consultation lists a number of authorised death benefit payments and whether they are in and out of the proposed changes in Annex B. The key benefits are listed below. As noted above, the current IHT exemption that applies in relation to transfers on death to spouses or civil partners will continue to apply. As such, if any of the payments which are to be brought into the scope of IHT are made to a spouse or civil partner, it would appear that those payments will continue to fall outside the individual's estate for IHT purposes.

Dependants' scheme pensions (whether payable from a DB or a DC arrangement) as well as a limited type of payment to a charity will remain out of scope for IHT following the changes.

In relation to DC arrangements, it is clear that a dependants annuity, drawdown pensions and other forms of annuities, as well as uncrystallised funds lump sum death benefits would all be included as part of a member's estate on death for IHT purposes. It is also clear that the Government intends for a five-year guarantee lump sum from a DB arrangement to fall within the scope of the proposals. Five-year guarantee lump sums are a type of lump which becomes payable if a member dies within five years of when their pension started.

It is less clear, however, whether insured death in-service lump sums (e.g., a multiple of salary lump sum benefit) will or won't be within scope of the proposed IHT changes. This type of benefit is currently common in both DB and DC arrangements. There is a comment in the consultation document (mentioned above) which 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 in this consultation document." This appears to suggest that insured lump sums will be excluded (even if they would, but for this statement, appear to be in scope of the proposals). We, alongside others, will be asking the Government to clarify this. We can see a rationale for excluding such payments as they are provided as an employee benefit while working for a particular employer, and are not capable of being manipulated for IHT planning purposes, even if they are often provided under the same trust as pension benefits.

Based on the technical consultation document, it does not appear that excepted group life arrangements will be impacted by the proposed changes, as they are not registered pension schemes. Usually, payments from these types of arrangements under discretionary trusts do not fall into a deceased member's estate for IHT purposes (although there are some exceptions to this).

New administration requirement for trustees

An important process point for trustees to note is that the Government intends to make trustees/pension providers responsible for liaising with deceased members' personal representatives in relation to members' estates and then to have a legal obligation to calculate and pay to HMRC the part of the member's IHT liability relating to the pension arrangement. The consultation raises various questions on the logistics of the proposed procedures.

Other relevant Budget announcements

Several significant Budget announcements were made in the employment sphere, as summarised in this client alert, including a rise in employers' NICs from 13.8% to 15% and a lowering of the earnings threshold on which they are paid.

Key considerations for trustees and employers

Generally, it is important for both employers and trustees to be aware of the future changes in this area, including the increased role that scheme administrators of registered pension schemes will have to play in the reporting and direct payment of IHT liabilities.

From a legal perspective, employers and trustees will, in due course, need to consider the structure of any death benefit arrangements and how these may be affected by the changes. As noted above, excepted group life policies do not appear to be within scope of the changes as currently framed in the technical consultation.

The changes raise questions around whether discretionary death benefit arrangements still make sense where their IHT advantages have fallen away. There may be reasons why employers wish to continue to use registered schemes to provide discretionary death benefits. For example, they may value the flexibility of this model, which can, in principle, allow death benefits to be paid by trustees to someone other than the deceased's nominated beneficiary or beneficiaries under a will if that is more tax efficient (there may, for example still be significant IHT advantages of paying to a spouse as opposed to a child) or taking into account family circumstances which have changed since the member completed their expression of wish form or will.

Employers may also be considering their overall pension offering in light of their increasing NICs liability, particularly if they are currently sharing any of their NICs saving on salary sacrifice arrangements with employees. Equally, for the minority of employers that do not currently operate a salary sacrifice arrangement, they may wish to consider entering into such an arrangement.

As noted above, a HMRC technical consultation on the processes relating to the IHT changes is running until 22 January 2025. We hope that, as part of the consultation response process, the current areas of uncertainty (for example, in relation to whether insured death-in-service arrangements are exempt from the IHT changes) will be clarified.

Finally, trustees and employers should be aware of potential further pensions proposals coming out of the Pensions Review. Initial findings from first part of this review, which is currently underway, and which is focused on investment, are expected later this year ahead of the introduction of the Penson Schemes Bill. The second phase of the review will start later this year and will also consider further steps to improve pension outcomes, including assessing retirement adequacy.

Please speak to your usual contact at Baker McKenzie if you would like to discuss this area further.

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