Local Government Association

HM Revenue and Customs
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Technical consultation – Inheritance Tax on pensions: liability, reporting and payment

Thank you for the consultation on the processes required to implement the changes to Inheritance Tax on pensions that were announced at the Autumn Budget 2024.

I respond on behalf of the Local Government Association (LGA) and the Local Government Pensions Committee (LGPC).

The LGA is a politically led, cross-party membership organisation that works on behalf of councils to ensure local government has a strong, credible voice with national government. 315 of the 317 councils in England are members of the LGA. These include district, county, metropolitan and unitary authorities along with London boroughs and the City of London corporation. The 22 Welsh unitary authorities are also in membership via the Welsh Local Government Association (WLGA).

The LGPC is a committee of councillors constituted by the LGA, the WLGA and the Convention of Scottish Local Authorities (COSLA). The LGPC considers policy and technical matters affecting the Local Government Pension Scheme (LGPS).

I hope the content is helpful. Please do not hesitate to contact me if you have any questions about this response.

Yours faithfully

Lorraine Bennett

Lorraine Bennett
LGPC Secretary

Background to the response

This response is submitted in the context of the Local Government Pension Schemes (LGPS) in England and Wales, and Scotland. The LGPS is one of the largest defined benefit schemes in the world. In England and Wales there are over 19,000 employers, 6.5 million members and assets of £400 billion. The scheme is administered locally by 86 administering authorities in England and Wales, and 11 in Scotland.

We thank HMRC for the engagement sessions they held with the sector during the consultation period. Parts of our response are based on the additional information provided by HMRC at these sessions.

In-service death benefits

We fully support the Government building a fair tax system and ensuring that tax reliefs are achieving their intended outcomes; however, we do not agree that bringing all defined benefit lump sum death benefits into scope of Inheritance Tax achieves this.

We question whether death benefits paid by defined benefits schemes should be in scope of Inheritance Tax. An LGPS pension must be paid from age 75. It is not possible for LGPS members to defer payment beyond age 75 in an attempt to avoid tax by passing on an unused pot.

The death grant paid when a member of a defined benefit pension scheme dies in service is commonly based on the individual's pay, not the size of their pension pot. This is the case in the LGPS, where the in-service death grant is three times the member's annual pay.

Bringing in-service death grants in scope of Inheritance Tax will disproportionately affect the families of younger, unmarried LGPS members who die in service. These may be single parent families or unmarried couples with children. The death of a parent could put these families in severe financial difficulty, and the deduction of Inheritance Tax from the LGPS death grant would worsen their financial position.

As a result of this policy, there will be a difference in the financial outcomes for two families with children, with one parent who dies as a member of the LGPS. If the death grant is paid to the surviving parent, it would be paid tax-free if the parents were married, but taxed if they were unmarried and the nil rate band threshold for Inheritance Tax was exceeded. This would introduce a disparity in treatment between married and unmarried couples that does not exist under the current LGPS rules.

We are in favour of changes that prevent individuals from misusing their pension (and associated tax relief) as a vehicle to pass on their wealth without paying tax when they die. We believe that pensions should be used to provide income in later life for scheme members. But the LGPS in-service death grant does not represent an asset that the member holds before death. We question whether in-service death grants of this type should be in scope of this policy.

The LGPS in-service death grant is similar to an insurance-based product that some employers adopt. We understand from Annex B of the consultation 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'.

We anticipate that private sector employers are more likely to move from a defined benefit lump sum death benefit to such life policy products because of the changes that are proposed. We do not yet know whether such changes would be allowed to public service pension schemes. If the LGPS was changed in this way, with 19,000 employers seeking to put life policies in place, employer costs would inevitably rise compared with the current arrangements. This increased cost would ultimately be met by local taxpayers.

Trivial commutation lump sum death benefits

The consultation confirms that a dependant's scheme pension will not be included in the value of an estate for Inheritance Tax. We support this exclusion as these pensions will be subject to income tax at the recipient's marginal rate. Trivial commutation lump sum death benefits will be included in the value of an estate for Inheritance Tax. In the LGPS, such a lump sum is paid instead of a small ongoing dependant's scheme pension. We do not believe that trivial commutation lump sum death benefits of this type should be in scope of Inheritance Tax. Both Inheritance Tax and income tax could be deducted from these payments, which would not be the case if the dependant chose an ongoing pension instead.

LGPS administering authorities often choose to pay trivial commutation lump sum death benefits to reduce their costs. Paying dependants a very small amount every month is not cost effective. Authorities are less likely to pay a lump sum instead if the recipient is going to be made worse off by having to pay Inheritance Tax, because it will inevitably lead to complaints. This will lead to an increase in administration costs which would ultimately be met by local taxpayers.

A trivial commutation lump sum death benefit is not always paid shortly after the death of

a member. An administering authority could choose to pay a lump sum in lieu of an ongoing LGPS pension at any time. Lump sums of this type could be paid many years after the member's death and therefore many years after the estate has been settled. The current proposals suggest that interest and late payment charges would then become payable. We do not believe that this is the intention of the proposals and recommend that these payments should not be in scope.

Discretionary schemes

Under current rules, an administering authority must exercise its discretion when deciding how an LGPS death grant should be distributed. This allows the payment to be made without the deduction of Inheritance Tax. Inevitably, some cases are more complex than others and administering authorities take care to gather all the relevant information before making their decision. See our response to Question 2 for more details.

If the LGPS retains this discretion, thought needs to be given to how the changes will affect the exercise of this discretion.

Under the current rules, the tax position is not affected by who the LGPS death grant is paid to. This will change under these proposals. A death grant paid to the spouse or civil partner will continue to be exempt from Inheritance Tax, but it would be subject to Inheritance Tax if it was paid to a child or other relative. This is an additional factor that could influence the administering authority's decision. But giving administering authorities another factor to consider could make the deadline of two months to make the decision more challenging.

As some death grants will be subject to Inheritance Tax in the future, the responsible authority for the LGPS may decide to change the regulations to remove the discretion. By taking this approach, the death grant would be distributed in accordance with the member's nomination, with a default position for cases where there is no nomination or the named beneficiaries have died or are untraceable. This may help administering authorities to meet the two month deadline for providing information to personal representatives (PRs).

This new policy also poses a problem for existing nominations made by members based on the current LGPS and over-riding tax rules, and therefore made without considering the potential impact of Inheritance Tax.

To take a simple example, an LGPS member may have expressed their wish for the death grant to be split equally between their spouse and their child. Under the new rules, Inheritance Tax may be due on the payment to the child, but not on the payment to the

spouse. The 50/50 split will be based on the death grant before any Inheritance Tax deduction. The child will therefore end up with a lower net amount, which may not have been the member's intention. Indeed, the member may have made a different expression of wish entirely had they considered the impact of Inheritance Tax.

The change will require a significant communication and member education exercise. Even though most members will not be affected by the change, it is not possible for the administering authority to identify which members will be affected. The only exceptions are pensioners in respect of whom no death grant will be paid because any pension guarantee has expired. All other members will need to understand the new rules and be encouraged to:

- review any death grant nomination they have made
- update it if they want to in light of the new rules
- make a nomination if they haven't already done so.

This will present a communications challenge, particularly in respect of deferred members who are generally less engaged with their pensions and pension providers.

Increased complexity

We have concerns about the level of complexity involved in administering a pension scheme, particularly a public service pension scheme. PSAs are not tax experts, but they must understand and apply an increasing amount of tax rules as part of their work. This change would mean that an LGPS death grant could be subject to a combination of Inheritance Tax (with possible interest and late payment charges), income tax or special lump sum death benefits charge. Which charges apply will depend on the date of death, the date of notification of death, the level of payment and who it is paid to. Clear and comprehensive HMRC guidance will be needed to explain how these charges interact in different circumstances.

Question 1: Do you agree that pension scheme administrators (PSAs) should only be required to report unused pension funds or death benefits of scheme members to HMRC when there is an Inheritance Tax liability on those funds or death benefits?

Yes, we agree that PSAs should only be required to report unused pension funds or death benefits where there is an Inheritance Tax liability. This policy will introduce new responsibilities, require process changes and significant member communication. We do not see the benefit in asking PSAs to report payments that they do not currently have to report and that are not subject to Inheritance Tax. Reporting them would be additional administrative work for no discernible benefit.

Question 2: How are PSAs likely to respond if they have not received all the relevant information from the PR to pay any Inheritance Tax due on a pension by the 6-month payment deadline?

Meeting the six-month payment deadline will be affected by the PSA's ability to meet the two month deadline for providing information about the pension scheme death benefits to the PRs. We believe that this deadline will be very challenging for LGPS administering authorities to meet.

The consultation document confirms that PSAs must 'respond to the PRs within two months of receiving a request'. In some cases, particularly where the person who reported the death has chosen to use the DWP 'Tell Us Once' service, the administering authority will already know about the member's death. In other cases, the PR's request for information about the death benefits payable may accompany the notification to the administering authority that the member has died. In these latter cases, the administering authority will only have two months to make a decision about the distribution of the death grant.

The consultation document draws a parallel with the existing requirement to share information with PRs about death grants in relation to the Lump Sum and Death Benefit Allowance (LSDBA). There is an important difference. The LSDBA requires the PSA to share information about the level of death grant that becomes payable. In general, two months would be plenty of time to supply this. In relation to Inheritance Tax, PSAs will also need to inform PRs who will be receiving the death grant. Deciding how the death grant will be distributed can take a considerable amount of time, making the two-month deadline very challenging.

LGPS administering authorities gather a significant amount of information before exercising their discretion to decide who any death grant should be paid to. Not all members complete an expression of wish form. Some members may have completed one many years before their death which:

- names beneficiaries who have passed away
- includes people whose connection with the member in the intervening time has ended
- does not include a new spouse or civil partner, nor children or other relatives born after the nomination was made.

Administering authorities take care to contact all known potential beneficiaries and give them an opportunity to disclose information about any other relatives and dependants. In

some complex cases involving multiple potential beneficiaries, two months would not be enough time for an administering authority to gather and consider all the information they need to make an informed decision. They must then choose between missing the two-month deadline, and therefore putting the six month payment deadline at risk, or making a rushed decision which is open to challenge.

Removing the discretion in the LGPS could speed up this part of the process. Care should be taken that doing so does not increase the likelihood of distributing a death grant in a way that potential beneficiaries see as unfair, causing an increase in formal complaints.

Question 3: What action, if any, could government take to ensure that PSAs can fulfil their Inheritance Tax liabilities before the Inheritance Tax payment deadline while also meeting their separate obligations to beneficiaries?

It is important to consider that beneficiaries of a death grant could be in an extremely vulnerable position. In addition to the distress of the death of a loved one, they may be facing severe financial hardship. The purpose of pension provision, particularly in relation to in-service death benefits is to alleviate that hardship. We support any proposals that could speed up the process involved in paying a death grant.

It is important to acknowledge that there is no easy way for PRs to collate a comprehensive list of assets and liabilities. Assets have become less easy to identify as most transactions are now done online with no paper evidence. Identifying an individual's pension can be particularly difficult when it is not in payment. In October 2024, the Pensions Policy Institute identified £31.1 billion in around 3.9 million unclaimed, inactive or lost pension pots. We question whether the current Inheritance Tax deadlines will still be appropriate once this policy is implemented.

The spousal exemption means that PSAs will know at an early stage that certain death grants will not be subject to Inheritance Tax. We understand that it will be possible for PSAs to pay death grants to spouses or civil partners at an earlier stage of the process, without waiting for PRs to finalise their Inheritance Tax calculations. We support this streamlined process – it will help PSAs pay the bereaved family what they are entitled to as soon as possible.

This option would not be available when the beneficiary is someone other than the spouse or civil partner. To alleviate hardship, PSAs could make payment of part of the death benefits at the earliest opportunity. If the PSA assumes that none of the nil-rate band will apply to the death grant, they could pay up to 60 per cent of the death grant as

soon as they have made a decision on its distribution. When the PR confirms how much of the nil-rate band should apply, the PSA could pay the Inheritance Tax and any remaining death grant to the beneficiaries. Such an approach could alleviate financial hardship of the beneficiaries with minimal risk of underestimating the Inheritance Tax due. The PSA could only underestimate the amount payable to HMRC in cases where the portion of the nil-rate band that applies to the payment is very small **and** the tax is paid after the six-month deadline meaning that interest becomes payable.

Another factor which currently causes delays in finalising payments when a pension scheme member has died is the limit set out in the Administration of Estates (Small Payments) Act 1965. The current limit of £5,000 has been in place since 1984. We recommend increasing this limit to allow more small payments to be made without the need for grant of probate or other proof of title. We understand that the limit has been raised to £20,000 in Northern Ireland. We support increasing the limit that applies in the rest of the UK to the same level, and to review and increase the limit regularly in line with inflation.

The pension industry is currently facing significant challenges following the rushed abolition of the lifetime allowance and the introduction of the Lump Sum and Lump Sum and Death Benefits Allowances. Some legislative changes were made more than six months after the changes came into effect. The Pensions Tax Manual does not yet reflect the latest legislative changes.

We appreciate that there is a longer lead-in period for this proposal. Clear and detailed guidance that is available as soon as the new legislation is in force will be welcomed by the industry. This will prevent delays as it will provide PSAs with a reliable source of useful information, rather than having to submit queries and wait for HMRC responses. It will also ensure that the rules are applied consistently across all pension schemes.

Question 4: Do you have any views on PSAs reporting and paying Inheritance Tax and late payment interest charges via the Accounting for Tax return?

The Accounting for Tax (AFT) return is currently submitted quarterly, with a deadline for submission 45 days after the end of the quarter. For estates that are finalised early in a quarter, the PSA could be submitting an AFT return four months later. This would make interest and late payment charges more likely. We understand that the Government is planning changes to the return in response to these proposals. We support changes that would allow PSAs to submit a return relating to Inheritance Tax as soon as they are able to, without reference to the usual quarterly timetable.

We are in favour of using the AFT return for this purpose. We believe it is preferable for PSAs to use a system that they already have access to, use regularly and are familiar with, rather than introducing an entirely new system.

Question 5: Do you agree that 12 months after the end of the month in which the member died is the appropriate point for their beneficiaries to become jointly and severally liable for the payment of Inheritance Tax?

We do not think that this should happen 12 months after the end of the month in which the member died. Instead, beneficiaries should become jointly liable after the death grant has been discharged.

An amendment may be needed when a new asset is identified or there is a change in the valuation of an asset. We understand that the PSA will only be involved in this process if they have not informed the PRs that they have discharged the death grant and 'extinguished' the pension pot. We support this position. Once the death grant is paid, the PSA will not hold any funds relating to the member with which to pay additional Inheritance Tax. It would not be practical nor efficient for multiple PSAs to be chasing the same beneficiaries for small amounts relating to underpaid tax. It makes more sense for this to be resolved between HMRC and the beneficiaries.

If beneficiaries do not become liable until the 12-month point, there is a risk that some cautious PSAs might delay paying a death grant until the 12 months have elapsed. This would ensure that they have funds available for any further tax demand. Such protracted delay could also add to the hardship of the beneficiaries, an outcome which could be avoided by changing the point at which liability changes.

Further detail is needed on how the process will work for beneficiaries who are owed a refund of overpaid Inheritance Tax. We would support a process that is as simple and quick for beneficiaries as possible.

Where additional Inheritance Tax is due, we would expect the PSA to be involved in cases where the adjustment is required because of a change to the level of death grant paid by the scheme or how it is distributed. See our responses to questions 6 and 8 for information about when this might happen in the LGPS.

Question 6: What is the most appropriate means of identifying or contacting beneficiaries if either the PR or HMRC realises that an amendment is needed after Inheritance Tax has been paid? Should PSAs be required to retain the details of beneficiaries for a certain period?

We understand that, after a death grant has been discharged, any amendment will be pursued by the PRs and HMRC. They will look to recover any underpayment of Inheritance Tax or arrange a refund. We support this proposal as it would not be proportionate to re-visit each element that makes up the estate individually to change the proportion of the nil rate band that applies to it.

If the death grant has not been discharged, PSAs will be able to re-calculate and amend the Inheritance Tax due if new information is received promptly from the PRs or HMRC. In practice, we do not expect this situation to arise often. The PSA must have already decided how the death grant will be distributed and passed that information to the PRs. Once the PRs share details of the nil rate band that applies, we would expect PSAs to act promptly to make payment.

The only time that we would expect the PSA to be involved in any amendments made after the death grant has been discharged is when an additional payment is payable from the pension scheme. In our view, the PSA should be responsible for paying the extra death grant that becomes payable and any Inheritance Tax that is due. The process needs to set out the PSA's responsibilities in this event.

There are certain death grants which will always attract an additional payment some months after the death of the member – see our response to question 8. Scheme regulation changes can also have a retrospective effect on the level of benefits payable and therefore change a past death grant. Retrospective changes could relate to deaths that occurred many years ago, as is the case with the McCloud remedy. Public service pension schemes are currently re-visiting past death grants for this and may be making top-up death grant payments in some cases. Although McCloud rectification should be complete before the proposals in this consultation come into force, any future retrospective changes could lead to top-up death grant payments being paid again.

LGPS administering authorities will retain details of death grant beneficiaries in line with their retention schedules. They are likely to review their policies in the light of any changes in this area. After a death grant is paid, an LGPS administering authority may also pay an ongoing survivor pension to one or more of the beneficiaries. When this is the case, they will keep contact details for the dependant up to date. If no survivor pension is being paid, the authority will keep details of the death grant recipients in accordance with their data retention schedule, but they will not be notified of any changes to the individual's contact details. Authorities will share information they hold with HMRC in line with information sharing regulations.

Question 7: What are your views on the process and information sharing requirements

set out above?

We recognise that this is a simple version of the process that is based on the assumption that all parties involved complete their responsibilities efficiently and effectively. In practice, this will not always be the case. We have provided further information in our response to question 8 about issues that may arise to disrupt the process.

As mentioned in our response to question 3, we think that PSAs could pay any death grants to a spouse or civil partner at an earlier stage of the process.

We also support:

- allowing PSAs to make an interim payment to beneficiaries to ease hardship in advance of receiving full details of the Inheritance Tax position (see our response to question 3)
- creating a backstop position to pay a death grant and Inheritance Tax in cases where there is no realistic prospect of the Inheritance Tax position being settled in a timely manner (see our response to question 8).

Question 8: Are there any scenarios which would not fit neatly into the typical process outlined above? How might we address these?

We recognise the pivotal role of personal representatives in this process. But we also acknowledge that they are sometimes vulnerable people who have suffered the bereavement of a close relative. PSAs may experience problems related to PRs such as:

- no PRs appointed
- PRs cannot be identified
- multiple PRs providing conflicting information
- PRs providing incorrect information
- fraud or misrepresentation
- unresponsive PRs
- PRs who do not communicate with the PSA because they are not aware that the deceased was a member.

Although it would not solve all these issues, a backstop position could be introduced that would allow PSAs to discharge a death grant when they have not received the relevant statement from PRs about the nil rate band that applies. Where the PSA believes there is no prospect of receiving full information from the PR within a reasonable timescale, the backstop could be employed on the later of:

- six months after the end of the month in which the member died (to align with the date on which interest charges on outstanding Inheritance Tax start to accrue)
- the date the PSA has made a decision about the distribution of the death grant.

Using the backstop would mean that the PSA assumes that no nil rate band applies to the death grant. Assuming that no exemption applies, they could deduct and pay 40 per cent Inheritance Tax plus any interest to HMRC and pay the remainder to the beneficiaries. The beneficiaries could then arrange to recover any overpaid Inheritance Tax once PRs fulfil their responsibilities. This approach would prevent small death grants from being wiped out as a result of prolonged delays and interest charges.

There are cases in which the process could be disrupted because of something that happens within the LGPS.

Supplementary Pensions Increase becomes payable on certain LGPS death grants in April following the member's death. It is our understanding that these additional payments would be in scope of these proposals. Depending on the date of death, it could be 11 months afterwards that the LGPS administering authority is able to confirm the total death grant payable. Administering authorities would face a choice between:

- missing the two-month deadline for providing information to the PRs – therefore making interest and late payment charges more likely, or
- proceeding based on a death grant figure that they know will increase.

We welcome any change that would allow small additional payments such as these to be made smoothly and without penalty. Alternatively, any payments that become payable under the Pensions (Increase) Act 1971 after the death grant has been discharged could be excluded from Inheritance Tax.

The process could also be disrupted when an individual makes a complaint about the calculation or distribution of a death grant through the scheme's Internal Disputes Resolution Procedure (IDRP) or to the Pensions Ombudsman.

Guidance would be welcome on the process that PSAs should follow when such a complaint has been made. How the death grant is distributed could affect the level of Inheritance Tax that is due. It would be helpful to know if PSAs would be expected to inform PRs when a complaint is made about the distribution of a death grant. There is a possibility that the distribution could change, depending on the outcome of the appeal. However, the complaint process is often protracted – a complaint can be made up to six months following the notification of the administering authority's decision. There are two

stages to the IDRP in the LGPS, and it can often take more than a year for the process to be completed. Following this process, there is then the option for an individual to take the complaint to the Pensions Ombudsman. An individual has three years to take a complaint to the Pensions Ombudsman, and it may take many more months for the Ombudsman to make a final determination. Holding up the PR's initial calculation for more than three years does not seem to be a proportionate response.

We noted our concerns about trivial commutation lump sum death benefits being in scope of Inheritance Tax in the introduction to this response. If they remain in scope, these payments will not always fit into the standard process. Payments of this type could be made months, even years after the death of the member. If they were to attract interest and late payment charges as set out in the consultation documents, these could easily exceed the value of the lump sum payment.

Question 9: Do you have any other views on the proposal to make PSAs liable for reporting details of unused pension funds and death benefits directly to HMRC and paying any Inheritance Tax due on those benefits? Are there any feasible alternatives to this model?

We understand the rationale for making PSAs liable for reporting and paying Inheritance Tax is to avoid the liquidity challenges that PRs currently experience. This can lead to beneficiaries having to draw down inherited pensions to reimburse PRs for Inheritance Tax. In some situations, this means that an additional charge arises on funds which have already been subject to Inheritance Tax.

We suggest that Government investigates whether it would be feasible for PSAs to be responsible for reporting and paying Inheritance Tax only in schemes where this situation would occur. If this approach were adopted, PRs would remain responsible for reporting and paying Inheritance Tax on all other unused pension benefits and death grants. This would be a simpler process and would result in far fewer Inheritance Tax submissions to HMRC.

We question whether making all PSAs responsible for paying and reporting Inheritance Tax is an appropriate solution. As HMRC estimates 92 per cent of estates will not be liable for Inheritance Tax, it doesn't seem proportionate to make around 30,000 pension schemes adopt this complex process, particularly when the double taxation issue does not occur in many of those schemes. Making PSAs responsible for reporting and paying Inheritance Tax will inevitably lead to delays in making payments and potential hardship for beneficiaries.