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). 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 of all types and 44 fire authorities across England are members of the LGA.

The response has been drafted by the Pensions Team at the LGA with particular reference to the Firefighters' Pension Scheme (FPS). The team provide employer and administrator support to various public service pension schemes, including the Local Government Pension Scheme (LGPS) and the FPS.

Please do not hesitate to contact me if you have any questions about this response.

Yours faithfully

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Background to the response

Under the scheme regulations, each of the 44 Fire and Rescue Authorities (FRAs) are responsible for the management and administration of their scheme and are defined in law as the scheme manager. This puts the responsibility to comply with overriding pension legislation on each of the political bodies charged with governance of the Fire and Rescue Service (FRS), i.e. Combined Fire Authorities, PFCCs, County Councils, Mayoral functions etc.

Each FRA is required to administer the pension scheme either in-house or through appointing a third-party administrator. There are currently 12 different pension administrators in England, ranging from single client sites to the largest administrator with 24 FRA clients. They are mostly not for profit organisations, with one known exception, and are often linked to LGPS administering authorities.

As the firefighters' pension scheme is unfunded, all administration costs must be met from fire authorities' operational budgets, which impacts directly on resource and their wider budget for firefighting.

While the scheme manager remains the legally responsible scheme administrator for the purposes of section 270 of the Finance Act 2004, in practice the FRA or delegated scheme manager relies heavily on the expertise of the appointed pension administrator to comply with the tax regulations and will rely on the pension administrator to undertake much of this proposed process.

It is the responsibility of each administrator to contract a software supplier that underpins their solution. There are two software suppliers who supply pension administration software for the FPS: Civica and Heywood Pension Technologies.

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.

Comments on the policy implications

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 for inheritance tax achieves this.

We question whether death benefits paid by defined benefit schemes should be in scope of Inheritance Tax.

The death grant paid when a member of a defined benefit scheme dies in service is commonly based on the individuals pay, not the size of their pot. This is the case for the FPS, where the death in service death grant is three times the members final pay. Final pay is defined as the greater of the following –

(a) the amount of pensionable pay and assumed pensionable pay during the last 365 days of continuous pensionable service, or

(b) the amount of pensionable pay and assumed pensionable pay during the last 3 years of pensionable service, divided by three.

A death grant may also be payable if a member dies after retirement, and they have been receiving pension payments for less than five years. In these circumstances, the death grant would be the difference between five times the annual amount of pension and the amount of pension paid. It is in effect a five-year guarantee of pension.

Based on the current FPS regulations, bringing death grants in scope of inheritance tax will disproportionately affect the families of younger, unmarried 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 FPS death grant would worsen their financial position.

This is particularly poignant for a firefighter, due to the inherent risk of the role, we are pleased to establish following the Inheritance tax workshop for public service, that emergency services are exempt from Inheritance tax if the death has occurred in the line of duty. It would have been welcomed however if this could have been set out in the consultation, as this was not something that we were aware of, having had very little involvement with HMRC's Inheritance tax rules.

There will however be a level of additional complexity to the process, as the scheme manager will need to determine whether the death was on duty.

We would also highlight that because of the Inheritance tax amendments, there will be a difference in the financial outcomes for two families with children, with one parent who dies as a member of the FPS. 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 limit was exceeded. This would introduce a disparity in treatment that does not exist under the current rules.

We would welcome sight of your equality evaluation and to understand how you determined equality over those who will be disproportionately affected by these

proposals.

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 FPS death in-service death grant does not represent an asset that the member holds before death. We question whether death in-service death grants of this type should be in scope of this policy.

The FPS death 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 FPS was changed in this way, with 44 fire authorities 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.

Discretionary schemes

Under current rules, a scheme manager must exercise its discretion when deciding how an FPS 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 scheme managers take care to gather all the relevant information before making their decision. See our response to Question 2 for more detail.

If the FPS retains this discretion, thought needs to be given on how the changes will affect how the discretion is exercised.

Under the current rules, the tax position is not affected by who the FPS 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 paid without tax, but it would be taxable if it was paid to a child or other relative. This is an additional factor that could influence the scheme managers decision. But giving scheme managers another factor to consider could make the deadline to make the decision more challenging.

As covered in our background section, there are 44 scheme managers and 12 pension administrators, to ensure consistency across the sector, clear guidance will need to be provided.

As some death grants will be subject to Inheritance Tax in the future, the responsible Government body for the FPS 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 poses a problem for existing nominations. Members will have made their existing nominations based on the current FPS rules and therefore will not have considered the potential impact of Inheritance Tax.

To take a simple example, an FPS 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. Based on how the process will work, 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 scheme manager to identify which members will be affected. 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 and costs

We have concerns about the level of complexity involved in administering a pension scheme, particularly a public service pension scheme. Pension Scheme Administrators are not tax experts, nor have they had previous involvement with Inheritance tax but they

must understand and apply an increasing amount of tax rules as part of their work. This change would mean that an FPS 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 HMRC guidance will be needed to explain how these charges interact in different circumstances.

Involving pension administrators and firefighters' pension scheme managers in a process that they have not been involved in previously will involved increased costs to the FRAs, in turn public sector money. The Fire sector is already struggling with the implementation of various remedies including Matthews and McCloud/Sargeant and the new IHT processes from 2027 give scheme managers and administrators little confidence of a period of stability before more major complex changes are brought in. We do welcome that the intention is that the legislation will be brought in with the Finance Bill in 2026, which does provide a years lead in time for the implementation.

Question 1: Do you agree that 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?

We agree that the reporting requirements should be consistent with other pension tax liabilities that are reported through the Managing Pension Schemes Service (MPSS); however, it is important to note that this will add cumbersome additional duties to the scheme manager's role.

As already set out in our background to the response section, across the fire authorities in England there are 44 individual scheme managers, most of whom this will only form a small part of their role and responsibilities, i.e. Chief Fire Officer being their main role and they will need to understand and then establish their own internal processes for dealing with these cases.

There is the risk that they will end up being required to pay late payment interest charges and will have to explain to beneficiaries of firefighters', who will already be grieving the loss of a loved one, why payments have not been made to them. The delay of payments in such circumstances is likely to cause significant distress to those concerned at a time when financial assistance is most needed.

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?

Scheme managers will only be able to send reminders to the PR to receive the necessary information, they do not have any other powers to enforce, and it does not appear that there will be any other escalation routes to ensure that they receive the necessary information in a timely manner.

This could lead to lengthy delays especially where the deceased member has complex arrangements or has more than one pension or assets that they cannot be sold until probate has been granted.

Application for probate is a minimum of 16 weeks but could be longer and could therefore impact when a PR provides the information to the scheme.

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 scheme manager 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 scheme manager that the member has died. In these latter cases, the scheme manager will only have two months to decide 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. This part of the process can take a considerable amount of time, making the two-month deadline very challenging.

Scheme managers could face late payment charges that are outside of their control if they are waiting for information from PRs.

Scheme managers will be faced with having to communicate to PRs and potentially apologising to beneficiaries for any delay in payments, where they are not one and the same.

We are concerned that there may be cases where there is no PR (where pensions are the only asset). How will the scheme manager know how much of the nil-rate band to apply?

Delays to death grant payments could result in complaints and could also result in compensatory payments being made in relation to the delays and distressed caused. Such payments would be made even though the cause is beyond the scheme managers

control and would be made directly from the fire authorities' operational budgets.

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?

The government could enforce that in all death cases a PR is appointed without delay, to avoid interest charges potentially accruing.

There may be cases where not all assets and/or pension information is readily available or that some schemes do not respond within the timeframes to provide the information to the PR. The government could enable inheritance tax liability to be assessed based on information available, which could then be amended after the event; however, this leads to other complications with how those amendments to the tax liability will be resolved.

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 death in-service death benefits is to alleviate that hardship. We support any proposals that could speed up the process.

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.

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 decided 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 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 have underestimated 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.

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 PSAs have a reliable source of useful information, rather than having to submit queries and wait for HMTC 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?

Firefighters' pension scheme managers are familiar with the Accounting for Tax returns, and we do not foresee any issues with reporting and paying inheritance tax payments via this method.

We do, however, have concerns about late payment interest charges. 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 however 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 to introduce an entirely new system.

Question 5: Do you agree that 12 months after 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 a valuation. 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 or ‘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 sorted out 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 from 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.

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 make up the estate individually to change the allocation of the nil rate band that applies to it.

If the death grant has not been discharged, PSAs should 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. An exception to this might be cases where an Internal Disputes Resolution Procedure is underway about the distribution of the death grant. PSAs are likely to delay payment until the dispute is resolved.

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 any extra amount of death grant that becomes payable. The process needs to set out the PSA responsibilities in this event. They may need to report the additional payment to HMRC and the PRs, or they may need to both report the payment and deduct any further Inheritance Tax that becomes due.

Scheme regulation changes can also have a retrospective effect on the level of benefits payable and therefore change a past death grant. Public service pension schemes are currently re-visiting past death grants in response to the McCloud ruling. They will be making top-up death grant payments in some cases. These could relate to deaths that occurred up to ten years ago. Although McCloud rectification should be complete before the proposals in this consultation come into force, a future retrospective change to regulations could mean top-up death grant payments being paid in the future.

FPS scheme managers will retain details of death grant beneficiaries in line with their retention schedules. Within the firefighters' pension scheme, pension records are usually retained for at least the lifetime of the pension that is to be paid. There may be some requirement to stipulate that records would need to be maintained for a certain period where there are no ongoing beneficiary payments. Scheme managers and PSAs are likely to review their policy in the light of any changes in this area. After a death grant is paid, an FPS scheme manager 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 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?

As the firefighters' pension scheme is a locally administered scheme, outside of HMRC, there will need to be a at least a three-way sharing in place between the PR, the scheme manager, and the pension administrator. The pension administrator is most likely to be the one to deal with the receipt and provision of information about the beneficiaries and amounts due to the PR. This will potentially increase scheme managers costs, as administrators may choose to increase their charges to consider this additional responsibility and work.

The scheme manager is responsible for using the MPSS, whilst in some cases they may delegate this to their administrator, at an additional cost, and will need to receive information from the administrator to report and pay the inheritance tax.

It will therefore be important to ensure that any process is flexible so that it works for locally administered schemes where the scheme manager will not have had sight of or is not directly involvement with all aspects of the process.

Overall, we have concerns about the timeframes that have been designated for each stage and whilst we appreciate that the government has a desire to deal with these cases swiftly, however each case is different, and there appears to be no flexibility, particularly in complex cases where there may be issues i.e. where a death is referred to the coroner, or where there are issues with obtaining probate and/or tracing assets at a time when a loved one has passed away makes the six month timeline exceptionally challenging for them. We strongly believe that under this new regime there is an argument to increase the deadline to a 12-month period or at least add in a 'by exception' to the 6-month period.

Data sharing will need to be amended to permit pension administrators to share personal details and financial details with the PR. Although it is not clear if the data sharing will go both ways, it would be helpful if clarification could be provided about what information HMRC would share with the scheme manager should the need arise, such as when a PR has not provided information to the scheme manager.

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 a bereavement. 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 scheme manager 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. If 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 because of prolonged delays and interest charges.

The process will 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 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. The most cautious approach would be to wait to provide information about the death grant and the beneficiaries to PRs until the complaint process has been exhausted. But 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 PRs initial calculation for more than three years does not seem to be a proportionate response.

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 believe that cases where an amendment is needed after Inheritance Tax has been paid are likely to be problematic. Under current rules, the Inheritance Tax nil rate band is apportioned across all relevant assets. This means that, where an additional asset is later identified, the portion of the nil rate band that applies to each asset changes, and consequently, the Inheritance Tax liability associated with each asset also changes.

Under the current proposal, pension schemes and beneficiaries would become jointly liable for Inheritance Tax 12 months after the member's death. One solution would be to:

- remove PSAs' liability for Inheritance Tax once death grant has been discharged, instead of 12 months after death
- make beneficiaries solely liable for Inheritance Tax on any assets identified after this point.

This would allow the beneficiaries to meet any additional Inheritance Tax liability from the new asset rather than amending the amount due from all other sources.

Another possibility would be not to use the apportioning method on any additional assets identified after the initial assessment. In cases where Inheritance Tax was paid at the initial stage, the new asset would be subject to Inheritance Tax at the 40 per cent rate, with no part of the nil rate band allocated to it. PSAs will already be aware that Inheritance Tax was deducted at the first stage and would not need to investigate further to find out the level of tax to apply. In cases where no Inheritance Tax was paid at the first stage, the new asset could tip the value of the estate over the nil rate band limit. In these cases, where the additional payment is being paid by a PSA, PRs would need to inform the PSA how much nil rate band is remaining. That part of the additional payment could be made without tax, with Inheritance Tax due on the remaining amount. In many cases, if no Inheritance Tax was due at the initial stage, none will be due when an additional asset is identified.

Both these approaches would mean that the beneficiary would see a single new asset and a single new Inheritance Tax charge, instead of a single new asset but multiple additional requests for funds to cover underpaid Inheritance Tax when the estate was originally settled.