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POLICY BRIEFING NOTE:

Autumn Budget 2024: Implications for the LGPS from inheritance tax changes

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Despite the frenzied pre-budget speculation, this week's budget was relatively short on direct pension related matters. However, there were a few items that are likely to be of interest to LGPS funds

In this bulletin, we consider the Government's consultation to bring unused pension benefits and death grants in scope for inheritance tax purposes, which will likely have the biggest impact on administration of those benefits. We also take the opportunity to look at one or two other items of LGPS-related small print and consider what they might mean for the Scheme.

Inheritance Tax on Death Grants

The current position

The LGPS regulations[1] allow for the payment of the following death grants on the death of a member;

	Death grant payable
Death in service	3 * assumed pensionable pay
Death on deferment	5 * pension that would have been payable
Death of a pensioner aged under 75	Balance of 10 years' pension guarantee

The recipient of the death grant is at the complete discretion of the administering authority which, in most cases, places the death grant outside of consideration for inheritance tax.

It is possible, however, for administering authorities to pay the death grant to the member's personal representative in which case it will form part of the estate. In such cases it is for the personal representative to determine whether inheritance tax is due on the estate, and to calculate and pay that tax.

[1] Earlier versions of the regulations provide for slightly different versions of the same benefits.

Also payable on the death of a member are survivor pensions paid to spouses, civil-partners, co-habiting partners and eligible children. These benefits are treated as income for tax purposes and under the budget proposals there will be no change to how they will be taxed.

Policy position

It is the Government's view that in recent years, pension schemes have been increasingly used and marketed as a tax planning tool to transfer wealth without an inheritance tax charge. Such tax planning is only really available through defined contribution arrangements, where members have much more flexibility over contributions. Nonetheless, for reasons of equity and revenue raising, the Government has decided that all death grants, including those paid from defined benefit schemes should be in scope of inheritance tax.

What is proposed?

The current inheritance tax regime allows all estates to pass on £325,000 to beneficiaries without incurring an inheritance tax charge. Above that value the excess is usually taxed at 40%, although various thresholds and exemptions also apply in certain circumstances (including the residence nil-rate band and exemptions for transfers between spouses and civil partners).

The idea is that death grants will now form part of the member's estate for inheritance tax purposes.

Under the new proposals, to be effective from April 2027, it will be the responsibility of the deceased's personal representative to obtain the value of certain death benefits payable from any former pension arrangements.

The personal representative will then calculate whether inheritance tax is due on the member's estate, using an HMRC online calculator which will be provided. Where inheritance tax is due, the personal representative must provide details to the relevant pension schemes. It will be for pension administrators to calculate the tax due, deduct it and pay it across to HMRC, before paying the death grant to the appropriate dependant.

The following example illustrates the process;

An LGPS member dies in service with a death grant of £200,000 payable.

The member's personal representative is dealing with the estate, worth £400,000. After liaising with the fund the personal representative obtains all the information required to calculate how the inheritance tax allowance of £325,000 should be applied.

Total value of the estate is £600,000 (£400,000 estate + £200,000 LGPS death grant)

The allowance is proportioned as follows;

Allowance to apply to death grant = £200,000/£600,000 * £325,000 = £108,333

Allowance to apply to remainder of the estate = £400,000/£600,000 * £325,000 = £216,667.

Armed with this information the fund can now pay the death grant to the nominated beneficiary.

Tax due on death grant = (£200,000 - £108,333) * 40% = **£36,667** (paid by the fund through the Accounting for Tax process)

Death grant payable = £200,000 - £36,667 = **£163,333**

Complications

Based on the above simple example the process sounds relatively straightforward, however, LGPS administrators will be acutely aware that life does not consist of simple examples. At the moment the payment deadline for inheritance tax is 6 months after the end of the month in which the death occurs. Late payment interest accrues on any inheritance tax which is not paid by this point. Is six months really sufficient time to carry out such a complex process?

Another question is, what will happen when there is no Personal Representative? Who will be responsible for gathering the appropriate information and informing the fund of how much allowance should apply?

It is also possible that the value of a member's estate could change as a result of retrospective adjustments to the valuation of assets and liabilities after the death grant has been paid. If that resulted in more of the allowance being available to apply to the death grant, then it would be relatively straightforward for the fund to calculate and pay any additional death grant.

However, if the value of the estate increases, the tax due on the death grant would increase. As the death grant has already been paid, how would the fund be able to pay the additional tax liability?

The consultation does acknowledge these points to some extent by proposing that after 12 months from the date of the member's death, the pension fund and beneficiary of the lump sum become jointly and severally liable for any tax. From the tone of the consultation the expectation is that from this point on HMRC will be able to pursue payment or repayments directly with beneficiaries as necessary.

Other matters

LGPS assets on the Government's balance sheet

In announcing the Government's fiscal rules, the Chancellor adopted a new definition of Government debt. The Government's debt targets will now be based on net financial debt, defined as public sector net financial liabilities (PSNFL). This is a broader definition than the previous measure and includes assets and liabilities held by funded public sector pension schemes.

The main reason for adopting PSNFL would appear to be the extra borrowing headroom it affords the Chancellor, but it will be interesting to see whether, having LGPS assets on the books will lead to increased government scrutiny in future. Please see our separate briefing note to find out more details.