GUIDE · A CHAPTER3 CLIENT GUIDE

Pensions, Inheritance Tax and *the 2027 Changes*.

Why the old rule of leaving the pension until last now needs another look.

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WHAT IS CHANGING

The pension is *joining the estate*.

For deaths on or after **6 April 2027**, most unused pension funds and pension death benefits will be included when Inheritance Tax is calculated.

That is a significant change.

For years, many retirement plans treated the pension as the last asset to spend because it usually sat outside the estate for Inheritance Tax. Cash, ISAs and general investment accounts were often used first, while the pension was preserved for children.

That approach may still be right in some cases. **It is no longer the automatic answer.**

In broad terms

- most unused pension funds and relevant pension death benefits will be included within the deceased person's estate;
- the change can apply to money-purchase pensions and certain death benefits arising from other registered pension arrangements;
- benefits passing to a qualifying spouse or civil partner may continue to benefit from the normal spouse or civil-partner exemption;
- death-in-service benefits payable from a registered pension scheme are excluded;
- personal representatives will normally be responsible for reporting and paying any Inheritance Tax due;
- the change applies where the pension member dies on or after 6 April 2027.

The change has been legislated through **Finance Act 2026**. Further regulations and detailed HMRC operational guidance are expected before implementation.

> **COLIN'S VIEW**
>
> *"The pension is still a very useful retirement wrapper. What has changed is its place in the estate plan. The tax answer and the retirement-income answer now need to be worked out together."*

WHAT HAS NOT CHANGED

Do not confuse a rule change with *a reason to empty the pension*.

Pensions still have important advantages during life:

- tax relief may be available on contributions;
- investments grow in a tax-advantaged environment;
- funds can remain invested for long periods;
- withdrawals can be planned across tax years;
- benefits passing to a spouse or civil partner may still benefit from the Inheritance Tax exemption, although the beneficiary's future Income Tax and estate position must also be considered;
- the pension can remain a useful source of later-life income.

The wrong response would be to withdraw large amounts purely to move money outside the pension. That could create:

- unnecessary Income Tax;
- more money sitting in the estate personally;
- loss of investment flexibility;
- reduced control over future income;
- a plan built around tax rather than the life the money needs to support.

> *The question is not, "How do we get the pension out?" It is, "Which assets should fund the lifestyle, which should be gifted, and which should remain available for later life?"*

THE OLD ORDER OF SPENDING

The old rule of thumb *has weakened*.

A common retirement-income order looked like this. The logic was that cash, general investments and ISAs were already within the estate, while a discretionary pension often was not.

From **6 April 2027**, most unused pension funds and relevant death benefits will also be included within the estate. That weakens the old default.

The order of spending should now be tested against the household's lifetime Income Tax, spending, gifting, beneficiary and estate position rather than inherited from a historic rule of thumb.

THE OLD ORDER

1. spend cash;
2. realise gains from general investment accounts;
3. use ISAs;
4. leave the pension until last.

The logic was simple. The non-pension assets were already inside the estate. The pension often was not.

THE NEW PLANNING QUESTIONS

Which withdrawals create the **least Income Tax** over the client's lifetime?

Which assets are most useful for **flexible spending**?

Which assets are likely to be **left to children** rather than spent?

Is there surplus income or capital that can be **gifted now**?

Should more income be taken from the pension during **lower-tax years**?

Does the surviving **spouse need the pension** for security?

What happens if **care costs or longevity** are greater than expected?

> *There is no universal new order. The right sequence depends on the whole household plan.*

WHO RECEIVES THE PENSION MATTERS

The beneficiary *changes the tax position*.

The new rules do not treat every beneficiary in the same way.

Spouse or *civil partner*	Benefits passing to a qualifying spouse or civil partner may be covered by the normal **spouse or civil-partner exemption** for Inheritance Tax. This may defer the Inheritance Tax issue rather than remove it. Any pension remaining when the surviving spouse or civil partner later dies may form part of their estate under the new rules. The survivor's income needs, tax position and wider estate must therefore still be modelled.
Adult children or *other family*	Where benefits pass to non-exempt beneficiaries, the pension may create an Inheritance Tax liability within the deceased member's estate. Income Tax can also apply when inherited pension benefits are paid or withdrawn. Broadly, where the member died **before age 75**, many defined-contribution death benefits can be paid free of Income Tax, subject to the form and timing of payment and the available lump sum and death benefit allowance. Where the member died **at or after age 75**, inherited pension withdrawals and most lump sums are normally taxable as income. Where both Inheritance Tax and Income Tax apply to the same pension benefit, the legislation includes relief intended to prevent Income Tax being charged on the part used to meet the attributable Inheritance Tax.
Trust or *charity*	Qualifying payments to charity may be exempt. Payments or nominations involving a trust can create different tax, control and administration consequences and should be reviewed with appropriate legal and tax advice.

> *The expression-of-wish form still matters. It just no longer solves the whole planning question by itself.*

A SIMPLE EXAMPLE

The same pension may now face *both Inheritance Tax and Income Tax*.

David dies in 2028 aged 78. His estate has already used its available nil-rate bands. He leaves a **£900,000** unused defined-contribution pension to his two adult children, with no spouse exemption available. To isolate the effect of the new rule, assume the full pension is exposed to Inheritance Tax.

STEP	AMOUNT
Unused pension allocated to non-exempt beneficiaries	**£900,000**
Illustrative IHT attributable to the pension at 40%	**£360,000**
Pension value remaining for the beneficiaries before any Income Tax on later withdrawals	*£540,000*

David died after age 75, so his children would normally also pay Income Tax when taxable inherited pension benefits are paid or withdrawn.

The legislation provides relief intended to prevent Income Tax being charged on the part of the pension used to meet the attributable Inheritance Tax.

The beneficiaries' actual Income Tax will depend on how and when they take the remaining benefits and their personal tax positions.

This is a deliberately simplified illustration. It assumes that all available nil-rate bands have already been used, no spouse or charity exemption applies, and the full pension is allocated to non-exempt beneficiaries. Real cases depend on the wider estate, pension scheme, beneficiary decisions, available allowances and the detailed administration of the estate.

> *The pension can no longer be reviewed separately from the will, nominations, lifetime spending and gifting plan.*

FOUR DECISIONS TO REVIEW

The planning response is *wider than the pension*.

1.
REVIEW THE *SPENDING ORDER*

Model withdrawals from pensions, ISAs, cash and GIAs across the expected lifetime. The aim is to manage lifetime Income Tax, estate tax and flexibility together.

2.
REVIEW *BENEFICIARY NOMINATIONS*

Check every scheme. Old forms, former spouses, missing contingent beneficiaries and vague instructions should not be left until the estate is being administered.

3.
REVIEW *LIFETIME GIFTING*

If the household has more than it is likely to spend, earlier gifts may be more useful than preserving every wrapper until death.

4.
REVIEW *ESTATE LIQUIDITY*

The family needs to understand how any Inheritance Tax may be paid and whether sufficient liquid assets will be available. Personal representatives may, in certain circumstances, be able to direct a pension provider to withhold part of the taxable pension benefits and pay the attributable tax to HMRC. The wider estate must still be planned so that administration does not force an unsuitable asset sale.

> *These decisions should sit inside a cashflow plan. Tax planning without an affordability model is only half a plan.*

THE ORDER OF ASSETS MAY CHANGE OVER TIME

One answer at 62 may be *wrong at 82*.

The best withdrawal order is rarely fixed for the whole of retirement.

Early retirement	There may be a window before State Pension or defined-benefit income begins. Pension withdrawals can sometimes be taken at lower marginal rates while ISAs remain available for later flexibility.
Middle retirement	Secure income may rise. Spending may begin to fall. The plan can review whether further pension withdrawals, gifts or ISA use now make sense.
Later life	The priorities may shift towards simplicity, care costs, attorney access and estate administration.

A sensible plan therefore reviews the order annually rather than setting it once and forgetting it.

COLIN'S VIEW

"The new rule does not create one clever answer. It removes one lazy answer. 'Leave the pension alone' is no longer enough of a strategy."

WHAT NOT TO DO

Four reactions that can make *the position worse*.

WITHDRAW THE PENSION IN *ONE LARGE AMOUNT*

This can create avoidable Income Tax and move the money directly into the individual's personal estate. It may also reduce investment and income flexibility.

GIFT MONEY WITHOUT *TESTING AFFORDABILITY*

A tax saving is not useful if the donor later needs the money for spending, care or security.

ASSUME THE SPOUSE EXEMPTION *FINISHES THE JOB*

The exemption may defer the Inheritance Tax issue until the surviving spouse or civil partner dies.
The survivor's own income, spending, care, beneficiary and estate position must still be modelled.

REWRITE NOMINATIONS *WITHOUT COORDINATING THE WILL*

The will, pension nominations, trusts and wider family plan should point in the same direction.

> *The objective is not to minimise tax at any cost. It is to keep enough money for the life ahead while passing on genuine surplus efficiently.*

What should be *on the agenda now*.

Pension values and *scheme type*	List every pension, whether it is in drawdown, the current beneficiary nomination and any scheme-specific death-benefit rules.
Whole-estate *calculation*	Add pensions to property, investments, business interests, life policies and other assets. Do not review the pension in isolation.
Lifetime *cashflow*	Test normal spending, higher early-retirement spending, market falls, longevity and possible care costs.
Withdrawal *sequencing*	Compare the Income Tax and estate-tax effect of different orders of spending.
Gifting *capacity*	Identify what is genuinely surplus, whether gifts should be made from income or capital, and what records are needed.
Legal and *protection review*	Update wills, LPAs, trusts and life cover where the estate needs liquidity.
Estate administration and *liquidity*	Identify who the personal representatives will be, which pension providers need to be contacted and how any attributable Inheritance Tax could be funded without unnecessary delay or asset sales.

WORKSHEET

The 2027 pension and *estate check*.

1.	Total unused pension value. *Include pensions in drawdown and uncrystallised pensions.*	£ __________
2.	Current nominated beneficiaries. *Names and relationship.*	__________
3.	Estimated estate including pensions. *Include property, cash, investments, business interests, life policies and pensions.*	£ __________
4.	Annual household spending required from all assets.	£ __________ *a year*
5.	Surplus identified through cashflow modelling. *Do not guess this figure. Complete it only where lifetime spending, longevity, care and market risks have been modelled.*	£ __________
6.	Main question to review before April 2027.	__________

A USEFUL TEST

"If you cannot answer questions 2, 3 and 4 with confidence, the starting point is not a tax product or a large pension withdrawal. It is a joined-up pension, cashflow and estate review."

NEXT STEP

Start with *the whole plan*.

The pension change is both an estate-planning issue and a retirement-income issue.

A 30-minute introductory call is usually enough to discuss whether the current withdrawal order, beneficiary nominations, gifting plan and wider estate need another look before April 2027.

Rough figures are enough for the first conversation. The latest pension values, current nominations, an approximate estate value and the income the household expects to need are a useful starting point.

BOOK A 30-MINUTE INTRODUCTORY CALL

BACK TO GUIDES

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