

Understanding the Coming Changes to Pension Tax on Death

The rules around pension tax on death have always been a maze of exceptions, allowances, and timing quirks. For years, pensions have been one of the most tax-efficient ways to pass wealth to the next generation. But that landscape is shifting. From April 2027, significant changes to inheritance tax and pension tax on death will come into effect, and anyone with a defined contribution pension or a defined benefit pension needs to understand what is coming.

For decades, the conventional wisdom has been simple: leave your pension pot untouched, nominate your beneficiaries on the nomination form, and let them inherit the money free of inheritance tax. That neat picture is about to become far more complicated. The government has announced that from April 2027, unused pension funds and death benefits will be included in the value of your estate for inheritance tax purposes. This is a fundamental shift in how pension tax on death is calculated, and it has implications for everyone.

How Pensions Are Currently Treated on Death

Right now, if you die before age 75, your beneficiaries can usually receive your pension pot as a lump sum or drawdown pension completely free of income tax. If you die after 75, they pay their marginal rate of income tax on withdrawals. Crucially, the pension itself sits outside your estate for inheritance tax purposes. That means a large pension does not push your estate over the nil rate band or the residence nil rate band. It is one of the reasons financial advisers have long recommended keeping pension wealth for last.

But this treatment is not set in stone. The rules change depending on whether you have a defined contribution pension or a defined benefit pension, whether benefits are in drawdown or not yet accessed, and whether the beneficiary is a spouse or a child. The pension scheme administrator will hold your nomination form on file, and that form determines who gets what. If you have not updated it recently, you could be leaving your loved ones with a tax bill they did not expect.

What Changes in April 2027

From April 2027, the government will bring unused pension funds and pension death benefits into the value of your estate for inheritance tax. This means that if your total estate - including your pension pot - exceeds the nil rate band of £325,000 and the residence nil rate band of £175,000, the excess will be taxed at 40%. The change applies to both defined contribution pensions and defined benefit pensions, though the mechanics differ slightly.



For a defined contribution pension, the value is straightforward: it is the amount in your pot. For a defined benefit pension, the value will be calculated by the pension scheme administrator using a formula based on the annual pension and a factor set by HMRC. This is likely to be a significant number for anyone with a generous final salary scheme.

The key date is the end of the current tax year before April 2027. If you die before that date, the old rules apply. If you die on or after that date, the new rules apply. This creates a cliff edge that could catch many people off guard, especially those who assume their pension is automatically free of inheritance tax.

Practical Implications for Estate Planning

The most immediate effect is that large pension pots will now push estates over the inheritance tax threshold. A couple with a combined nil rate band of £650,000 and a residence nil rate band of £350,000 (because the unused band can transfer to a surviving spouse) can currently shelter up to £1 million from inheritance tax. Add a £400,000 pension pot, and that estate suddenly owes tax on £150,000 at 40%, which is £60,000. That is a real cost that could have been avoided under the old rules.

There is also the question of timing. If you die before age 75, your beneficiaries still receive the pension tax-free for income tax purposes. But now that same pension will count toward your estate for inheritance tax. So a 70-year-old with a large pot could die and leave their children a lump sum that is free of income tax but subject to inheritance tax. That is a double hit the old rules avoided.

For beneficiaries who are not a spouse or civil partner, the situation is even more complex. They will receive the pension death benefit subject to their own income tax rate if you die after 75, and now the value of that benefit will also have been subject to inheritance tax in your estate. This double taxation is not new in principle - it already applies to other assets - but it is new for pensions.

What You Can Do Now

First, check your nomination form with your pension scheme administrator. This is the document that tells the scheme who you want to receive your benefits. If it is out of date, your wishes may not be followed. The nomination form also determines whether the pension is paid as a lump sum or as drawdown, which affects the tax treatment for your beneficiaries.



Second, consider your overall estate planning. If your pension pot is large, you may want to draw down some of it during your lifetime and give the money away, or use it to purchase an annuity that provides income but has no residual value on death. An annuity can be a useful tool because it removes the pension pot from your estate entirely, though you lose control over the capital.

Third, think about the timing of any pension commencement lump sum. If you take a tax-free lump sum at retirement, that money comes out of the pension and becomes part of your general estate. That may or may not be beneficial depending on your other assets and your inheritance tax position. A financial adviser can model the numbers for you.

Fourth, if you have a defined benefit pension, ask your pension scheme administrator for a statement of the capital value of your benefits. This is the figure HMRC will use to value the pension in your estate. It may be much larger than you expect, especially if you have a long service record and a high salary.

Finally, remember that the residence nil rate band only applies if you leave your home to direct descendants. If your estate plan leaves the house to a trust or to a sibling, you lose that allowance. The interaction between the residence nil rate band, the nil rate band, and the new pension rules is where most of the complexity lies.

Is It All Bad News?

Not necessarily. The change brings pensions into line with other assets for inheritance tax, which simplifies the overall system. It also means that estate planning can become more straightforward for people who previously had to navigate two separate sets of rules. And for those with smaller pension pots, the change will have no effect at all, because their total estate will still fall within the nil rate band.

The real losers are people with large pensions who die after April 2027 without having planned for this change. The winners are the Treasury, which expects to raise significant revenue from this measure over the coming years. For everyone else, it is a reminder that tax rules are not permanent, and that the advice you received ten years ago may no longer be valid.



Final Thoughts

The coming changes to [pension tax on death](#) are not a reason to panic, but they are a reason to act. If you have a defined contribution pension or a defined benefit pension, if you have a nomination form that has not been updated in years, or if you simply assume your pension is free of inheritance tax, now is the time to review your situation. The rules change in April 2027, and the tax year before that date is your window to make adjustments.

Speak to a financial adviser who understands both pensions and inheritance tax. The interaction between the pension commencement lump sum, drawdown pension, annuity choices, and the new inheritance tax rules is too complex to handle with a quick online calculator. A good adviser will help you decide whether to leave your pension untouched, draw it down, or use it to fund a gift to your beneficiaries while you are still alive.

The pension tax on death landscape is changing. With the right planning, you can still pass your pension wealth to the people you care about without handing half of it to HMRC. But that planning needs to start now, not in 2026.