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Your ref
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By email to: ihntonpensions@hmrc.gov.uk

Dear Assets, Residence and Valuation Team

Technical consultation - Inheritance Tax on pensions: liability, reporting and payment– USS response

The Trustee of the Universities Superannuation Scheme (USS) welcomes the opportunity to respond to the *Inheritance Tax on pensions* technical consultation.

Firstly, I'd like to express my thanks to you and your colleagues for taking the time to provide the detailed workshops, which were very helpful in shaping our thinking.

About USS

Universities Superannuation Scheme (USS) was established in 1974 as the principal pension scheme for universities and higher education institutions in the UK. We work with around 330 employers to help build a secure financial future for 554,000 members and their families. We are one of the largest pension schemes in the UK, being a hybrid pension scheme, with both a defined benefit (DB) part and a defined contribution (DC) part, and total assets under management of £77.9bn at 31 March 2024.

As well as paying benefits which support members in their retirement, and later their spouses and dependants, the USS Trustee (the Trustee) can pay a number of discretionary lump sum benefits when a member dies. Generally the Trustee decides to whom these benefits are paid but members are able to make a non-binding nomination of potential beneficiaries. The most significant of these benefits are:

- If a member dies whilst still working (death-in-service), the Trustee pays a discretionary lump sum benefit based on the member's salary. This payment aims to both support a grieving family at a difficult time (meaning they have less to worry about in relation to money, especially the additional costs and expenses incurred), and in the longer term dealing with the loss of an income to the household. Similarly, in this scenario if the member has unused DC funds in USS these may also be paid as a discretionary lump sum after death. In 2024, the average age at death that gave rise to this benefit was 54.

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- the Trustee can also pay a discretionary lump sum death benefit to deferred members who have not attained Normal Pension Age. In 2024, the average age at death that gave rise to this benefit was 53.
- If a member dies after retirement then the Trustee will pay to their beneficiaries a discretionary lump sum (if death is within 5 years of retiring), and any unused DC funds.

1. Our concerns with aspects of the application of Inheritance Tax (IHT) to pension scheme death benefits

Whilst we appreciate this is a consultation on the operational aspects of paying lump sum death benefits which fall under the IHT regime from a pension scheme, we start by voicing our **strong concerns** in relation to some aspects of the proposed application of IHT to pension scheme benefits.

The inclusion of DB discretionary lump sum death benefits, and particularly death-in-service lump sums and deferred death benefits that become payable prior to minimum or normal pension age, is inconsistent with our understanding of the aim of the change i.e. applying IHT to assets forming part of an estate which an individual was able to control and make plans for their benefits. These discretionary pension scheme death benefits are effectively life assurance benefits which provide much-needed financial support to distressed beneficiaries following the difficult period after death and through the longer term loss of a household income.

Whilst we can understand the view that some individuals may have been choosing to use DC pension schemes at least partly as a tax-efficient way to pass on assets after their death and therefore that the Chancellor wishes to align the IHT treatment of these DC pension benefits with the treatment of other assets on death, the inclusion of DB benefits (particularly death-in-service lump sums and other death benefits payable before normal retirement age) does not align with that. (We would also note that in some hybrid scheme cases, like USS, a DC fund may actually be effectively an extension of their DB retirement benefits – in USS’s case contributions on salary above an agreed threshold provide DC benefits rather than DB benefits – and so these cases arguably do not align with the Chancellor’s aims also.)

In particular, a death-in-service lump sum is effectively a life assurance benefit – it is not an asset which the deceased is able to accumulate or manage, and for pension schemes like USS they cannot direct to whom it is paid. The aim of such benefits is not to pass on wealth or accumulated assets to specific beneficiaries but to provide much-needed financial support to distressed beneficiaries to help them following a difficult period after death and in the longer term to help them deal with the unplanned-for, and in many cases, sudden, loss of an income (as noted above in 2024, the average age at date of death where death occurred during active pension membership was 54). It is therefore inconsistent to include these benefits in the scope of IHT.

Applying IHT (and the resulting administrative processes) to such benefits will cause delays in payment, which in turn could cause additional distress and inconvenience at an already very difficult time.

Including these discretionary lump sum benefits (particularly death-in-service benefits) in the scope of IHT also has what we presume are unintended consequences: as we set out in our response below, the need to take death-in-service payments through the required IHT administrative process risks delaying their payment significantly.

As noted above one of the aims of such payments is to provide financial support in the period after death where there were likely to be additional costs arising, whilst at the same time household assets or sources of funds have been potentially frozen and the estate is yet to be distributed. We are greatly worried that having to go through the process of locating a legal personal representative (LPR) and waiting for that LPR

to confirm the IHT position risks delaying payment of the benefit by a significant amount of time, causing additional distress at a difficult time.

Applying IHT to such benefits introduces unfairness and inconsistencies.

For many open DB and hybrid schemes like USS, providing protection for active members (and their dependents) in the event of death or incapacity is a key purpose of the scheme. Indeed, such schemes remaining open to new members and/or new accrual has been in part due to such benefits being valuable to both members and employers. There are both administrative efficiencies and clarity for members (and their dependents) in engaging with a single retirement and death benefit scheme.

We are therefore deeply concerned that applying this treatment to discretionary death-in-service lump sums from pension schemes such as USS introduces an inconsistency and unfairness with life assurance policies where the benefits are distributed via trust (which will remain outside the scope of IHT). The estates of members of pension schemes that provide both death and pension benefits will be penalised compared to members of arrangements where the benefits are offered via separate trusts. Providing benefits via a single trust is not a member choice and will reflect longstanding choices by employers and others – such arrangements are unlikely to be easily unbundled (and might introduce wider detriment to members in so doing). It would also appear to be inconsistent with wider Government policy which recognises the value of DB and hybrid schemes remaining open.

We recognise that the Government has an ambition to align the IHT treatment of death benefits from schemes that are not under trust. While there may be comfort in a simplistic headline alignment with benefits offered under trust, it does not recognise the very different backgrounds to these benefits and creates a much greater inconsistency with life assurance policies (and an unfairness to members).

We understand the above points will also be being made widely by the pensions industry but we feel it is important to make them here - we trust that you will give them the consideration they clearly need even though they nominally fall outside the scope of this consultation.

We now move onto the issues raised specifically by this consultation.

2. Our specific areas of concern in relation to the operational aspects raised by this technical consultation

In relation to the operational aspects of applying IHT processes to the administration of pension scheme death benefits, we have answered the consultation questions in the Annex. However, we would like to highlight two specific areas of concern first - in summary they are:

- i. The additional workload and costs imposed on Pension Scheme Administrators (PSAs) by the proposals
- ii. The timescales imposed by the proposed operational process.
- iii. The provision of beneficiary information to the LPR.

Further detail on these points is set out below.

i. The additional workload and costs imposed on PSAs by the proposals

Firstly it is clear that the proposals effectively transfer the responsibility for IHT revenue collection to a PSA in relation to pension scheme death benefits. PSAs already have numerous responsibilities in relation to the pension scheme they operate, and that burden is increased at the moment as they deal

with changes to the Lifetime Allowance, preparation for pensions dashboards, GMP equalisation and so on. Adding this responsibility (and not simply adding it to the LPR's existing IHT responsibilities) will add additional work and complexity to the PSA's role.

In turn this additional work and complexity will lead to increased costs for pension schemes. For DB schemes like USS who aren't commercial entities the costs of administering the scheme are met from scheme assets (which are of course the funds used to pay members benefits) and so the Trustee is always mindful of the potential impacts of any proposals which would increase those costs.

HMRC should therefore think seriously about amending the proposals so that the IHT reporting and payment responsibilities remain with the LPR, consistent with IHT on other parts of an individual's estate. The rest of our response however addresses the current proposals i.e. that this burden be imposed on PSAs from 2027.

ii. The timescales imposed by the proposed operational process.

The consultation document proposes to make pension scheme administrators liable for reporting details of unused pension funds and death benefits directly to HMRC and paying any IHT due on those benefits. It also states that late payment interest will accrue from the date 6 months after the end of the month in which the death occurred. **However, making payment within this 6 month window will often be difficult to achieve for trustees who are under a fiduciary duty and must properly exercise their discretion in the payment of these benefits, leading to Pension Scheme Administrators (PSAs) being liable for interest due to circumstances outside their control, and potentially having to pay that interest out of scheme funds.**

In the last five years, it took on average 55 days from the date of death for the Trustee to be notified of a death in service, increasing to an average of 170 days where the deceased was a deferred member of USS. This reflects a significant portion of the 6 month deadline proposed, a period during which the Trustee would be unaware of a death having occurred.

In the 2023-2024 scheme year, in the event of the death of a member in service it took the Trustee on average 15 weeks from the date of notification of the death for a discretionary death lump sum to be paid.

- 14 weeks of this timescale related to the work required to ascertain the potential beneficiaries and the identify various relationships and circumstances of those in relation to the deceased member, consider USS's governing provisions, make appropriate enquiries, collate the necessary information, and exercise the Trustee's discretion as to whom the payment(s) should be made. There can be circumstances beyond trustees' control which delay such payments – we set out some examples in the Annex in our response to consultation question 2.
- The final week related to actually making the payments – the Trustee's current processes put it in a position to make payment almost immediately once the Trustee has exercised its discretion for the distribution of the lump sum death benefits.

As a result largely of the above two factors, 49% of lump sum death benefit payments paid within the last five years took the Trustee more than 6 months from the date of death to be completed.

In addition, the proposed new approach introduces additional work to inform the LPR about that decision and await the tax information back from the LPR (after they have collated information from all other PSAs) before making a payment. We anticipate that this additional set of processes will further increase our average processing time, and this could prove particularly problematic should the LPR

encounter delays collating information from all external parties in relation to the estate, which is entirely outside the control of the Trustee.

As a result it is conceivable that a PSA would incur interest charges each year across multiple cases due to circumstances largely beyond their control. The Trustee does not believe that it is a fair or appropriate use of USS monies (which are of course the funds used to pay members' benefits) to pay interest on top of the IHT payable if the delay in the process arises due to circumstances outside its control (including delays caused by the LPR). Whilst we have not yet determined the approach for our own processes, it is possible that PSAs will decide to automatically pay any 40% IHT liability at the 6 month deadline and report this via the Accounting for Tax (AFT) process. Whilst this will avoid interest accruing, it will mean that there may be a need to engage with HMRC at a later date to go through the IHT amendment process where it is subsequently identified that IHT has been over (or under) paid (although we do have a proposal to simplify this – see ii below).

We would therefore urge HMRC to consider an alternative process. By way of an example a process more closely linked to the AFT process may be more suitable. PSAs currently submit an AFT return on a quarterly basis in line with HMRC timescales: to reduce the risk of late payment, and reduce the volume of AFT submissions, HMRC could align the IHT deadline with current AFT reporting timescales and allow 6 months from the end of the quarter in which the death occurred to pay the IHT liability. This would generally allow more time, and also allow PSAs to include any IHT payments as part of the normal AFT submission, rather than on an ad-hoc basis.

Alternatively (or in addition), we would suggest making the LPR or beneficiaries liable to comply with the 6-month deadline for payment to encourage the timely provision of information within the deadlines.

Finally, as noted above, the additional LPR processes and the effect of those on timelines could also mean a longer wait time for payments to beneficiaries at what is already a very difficult and distressing time.

iii. Providing beneficiary information to LPR

The consultation document proposes that we share sensitive personal beneficiary information (e.g. National Insurance number, date of birth and address) with the LPR, a process which could create additional data security risks. It is our view that being required to do so goes against several principles of the Data Protection Act, such as purpose limitation, data minimisation and being fair and transparent. Sharing the information could also potentially lead to harm or distress to the individual if the LPR became aware of beneficiary information (such as address) to which they were not previously privy.

In view of this, we would ask HMRC to instead require that PSAs/Trustees only provide minimal beneficiary information to the LPR (such as the beneficiary's relationship to the deceased and their entitlement) and instead require all lump sum death benefits to be reported to HMRC with the beneficiary designatory details. By doing so, this could also reduce the need for PSAs/Trustees to be involved in the amendments process should any change to the IHT liability be identified after payment via the AFT, as HMRC will already have received all the relevant beneficiary information in order to rectify the tax position directly with the recipient of the lump sum.

Furthermore, this would reduce the amount of information required by the LPR from the member's various pension arrangements, which in turn could reduce the overall timescale for the IHT calculation to be completed, for example if there are delays in receiving designatory details from the beneficiary.

Individual responses to each of the questions raised as part of the consultation can be found in the Annex

to this document.

In conclusion

We feel it is important that, if possible, HMRC reconsider the application of IHT to pension scheme DB death benefits, particularly death-in-service lump sum benefits – these do not appear to be the type of benefits the extension of IHT to pension schemes was intended to capture, and the IHT processes are likely to cause delays to their payment at a difficult time for the beneficiaries.

We have also made a number of points and suggestions around how to adjust or improve the operational processes for IHT on pension scheme death lump sum payments which we believe will ease the process for all parties without causing any significant difficulties.

We hope these points will be taken on board by HMRC and acted on.

Yours sincerely

Carol Young
Group Chief Executive Officer

Annex – Technical consultation - Inheritance Tax on pensions: liability, reporting and payment**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?**

Whilst this is consistent with the current process for only reporting lump sum death benefits that exceed £1.0731m (for Lump Sum and Death Benefit Allowance purposes), in conjunction with our proposal under question 7 that we share beneficiary designatory details directly with HMRC, we would propose that all unused pension funds or death benefits should be reported to HMRC.

Providing this information directly to HMRC would also reduce the PSA involvement if it were later identified that the IHT liability requires amendment following payment, as well as minimising the beneficiary information that would need to be shared directly with the LPR.

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?

As set out in our letter, PSAs have little recourse where a delay to payment is outside of their control as this could be the result of a number of external factors. Examples experienced by the Trustee include:

- The existence of a partner who was not nominated through an Expression of Wish (EoW) form.
- The absence of a will or an EoW form which would mean the Trustee needs to investigate and explore other sources of information.
- The existence of multiple possible beneficiaries and conflicting family views on who should be treated as a beneficiary.
- If the beneficiary is a child under 18 the lump sum payments are required to be set up under USS' own trust which can take over 6 months to establish.
- Delays in receiving information from Probate.
- The death of a member which occurred overseas, or beneficiaries who live overseas.
- The delayed notification of a death to the Trustee.

Therefore, we envisage that PSAs will automatically pay the 40% IHT liability at the 6 month period and report this via the AFT to avoid interest accumulating (unless it is clear that the benefit will be paid to a spouse/civil partner and therefore will not attract IHT) and allow the tax liability to be rectified via the amendment process if needed.

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?

Our experience is that exercising a trustee discretion and paying lump sums in these circumstances can be a complex matter. Aligning the IHT payment deadline with the current two-year period in which the Trustee must make a lump sum death benefit payment following the notification of a death would ensure that trustees are able to properly exercise their discretion and meet their obligations to beneficiaries. At the end of the two-year period, the discretionary obligations would fall away and the lump sum payment

would be made directly to the LPR, allowing PSAs to pay and report accurate IHT liability to HMRC and to the LPR.

In addition, we believe that making the LPR and beneficiaries jointly liable for the paying the tax if the PSA is unable to do within the deadline would assist in reducing the timescale for establishing a list of potential beneficiaries and would encourage faster response times from LPR/beneficiaries to facilitate payments.

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 proposals set out in the consultation would increase the volume of AFT submissions required by PSAs, who currently submit an AFT return on a quarterly basis in line with HMRC timescales. To reduce the risk of late payment, and minimise the amount of AFT submissions, it would seem more appropriate to align the IHT deadline with current AFT reporting timescales and allow 6 months from the end of the quarter in which the death occurred to pay the IHT liability. This would allow PSAs to include any IHT payments as part of the normal AFT submission, rather than on an ad-hoc basis.

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 would suggest that HMRC consider that the LPR and beneficiaries become jointly and severally liable from the 6 month deadline. We envisage that this would encourage faster responses from beneficiaries, and in conjunction with our proposals set out in this letter, would mean that the beneficiaries would be responsible for any amendments to the IHT position directly with HMRC should it transpire that the level of tax initially paid by the PSA was incorrect as a result of the information submitted by the LPR.

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?

Our suggestion is that, at the point the PSA pays the LSDB, the beneficiary designatory details should be reported to HMRC. If the LPR then reports any changes to the tax position to HMRC through the amendments process, HMRC would have all the available beneficiary information in order to correct the position directly with the recipient which would likely be quicker and more efficient.

Question 7: What are your views on the process and information sharing requirements set out above?

Currently, all deadlines imposed on trustees/PSAs are with reference to the date they are made aware of the member's death, meaning that trustees are not penalised where deaths are not notified to them, or where an extended period of time elapses between the date of death and the date of notification. This is not the case for the proposed IHT deadlines which are linked to the actual date of death - it is our view that the IHT deadlines proposed should align with the date trustees/PSAs first become aware of a member's death.

Secondly, we view the 6 month deadline prior to interest accruing to be unreasonable, on the basis that a significant proportion of this timescale will be used by the period between death and actual notification to trustees, by trustees in order to identify possible beneficiaries, to gather information and make appropriate enquiries, and then await information from the LPR - all largely outside of the trustees' control. In light of this we would suggest that the LPR/beneficiaries are liable for any interest imposed.

Thirdly, in order for trustees to properly execute their discretionary powers, the 12 month payment deadline should be aligned with the two-year period that applies to lump sum death benefit payments.

In relation to the data-sharing requirements, we are uncomfortable with the requirements of sharing beneficiary information with the LPR when considering trustees' Data Protection Act obligations. Limiting the information shared with the LPR to the amount of lump sum payable to each beneficiary and the beneficiary's relationship to the deceased would be sufficient to allow the LPR to undertake the IHT calculation. It is our view that this would also expedite the information sharing process, as PSAs will not be required to wait until all beneficiary designatory information is available before providing the LPR with details. Allowing PSAs to instead report beneficiary designatory information directly to HMRC upon payment will enable HMRC to work directly with the LPR and beneficiaries should any amendments to the tax liability be undertaken via the amendment process.

Finally, from an operational perspective, indexing the reporting deadlines with reference to the date of death would marginally increase the volume of ad-hoc AFT submissions and as a consequence increase the risk of reports being missed. By aligning the AFT reporting deadlines to the quarterly AFT windows already in existence, this would capture lump sum death benefits as part of the regular AFT submission.

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

When a lump sum death benefit payment is made outside of the two-year period and as a result is subject to the special lump sum death benefits charge, this payment is made directly to the LPR subject to the 45% tax charge. This could impact the LPR's initial assessment of the IHT liability if, at the time the LPR notified us of the death, it was intended that the lump sum would have been paid to a spouse/civil partner/child. Also, as set out above, we envisage that PSAs might automatically pay the 40% IHT liability at the 6 month period and report this via the AFT to avoid interest accumulating.

However, if the final deadline (currently proposed at 12 months following the end of the month from the date of death) for the IHT account to be submitted were to be aligned with the current deadline for payment of a lump sum death benefit (i.e. two years from the date of notification), this would allow PSAs to report on any IHT arising at the same point HMRC are notified of the special lump sum death benefit charge, with any amendments being rectified directly between the LPR and HMRC thereafter.

Consideration also needs to be given to how IHT would interact with other tax liabilities on lump sum death benefits (for example, special lump sum death benefits tax charges, cases where a member was over age 75 at their date of death, or where benefits exceeded the member's available Lump Sum and Death Benefit Allowance). This raises a number of queries, for example would it be the non-taxable elements only that fall into scope of the member's assets? How would both tax charges be applied to the gross lump sum or would they be applied in a specific order? Do benefits subject to IHT count towards the late member's Lump Sum and Death Benefit Allowance?

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 would consider that PSA involvement in the amendments process following the discharge of a lump sum payment to be inconsistent with the current processes. Reporting lump sum and beneficiary information directly to HMRC by the PSA would permit any amendments to the tax position to be handled more quickly and efficiently between HMRC, the LPR and the beneficiaries.