

Consultation Response

Finance Bill 2025-26

Reforms to Inheritance Tax –
Unused pension funds,
death benefits, agricultural
property relief and
business property relief

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Introduction

The Law Society of Scotland is the professional body for over 13,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Tax Law, Pensions, Trusts and Succession and Property and Land Law sub-committees welcome the opportunity to consider and respond to the UK Government's proposals within Finance Bill 2025-26 concerning unused pension funds, death benefits, agricultural property relief and business property relief.¹ The sub-committees have the following comments to put forward for consideration.

Reforming Inheritance Tax — unused pension funds and death benefits

As stated in our previous response to the UK Government's technical consultation in January 2025, making unused pension funds and death benefits liable for Inheritance Tax (IHT), and the proposed new approach to reporting and payment requirements for pension schemes, do create a number of complexities and possible unintended consequences.² We have further comments on the detail of the legislation proposed below and would welcome the opportunity to engage further with HMRC on this draft legislation.

Clause 1

We would suggest consideration should be given to replacing the word "employment" in the proposed section 150A(6) of the Inheritance Tax Act 1984 (the 1984 Act) with the word "service". This would avoid the unintentional consequence of excluding certain categories of member benefiting from the IHT exemption applying to death in service benefits payable from registered pension schemes.

¹ [Finance Bill 2025-26 - GOV.UK](#)

² [Inheritance Tax on pensions: liability, reporting and payment](#)

In regard to the provisions to exempt death in service benefits, benefits which are provided via standalone registered pension arrangements may not meet the new definition and could, therefore, fall into the deceased's estate for IHT purposes.

We understand that the policy intention is that "death-in-service benefits" are to be excluded from the types of pension property which will be brought into a deceased individual's estate for IHT purposes under the proposed section 150A(5) of the Inheritance Tax Act 1984".³ The wording of the proposed section 150A (7), which provides the definition of "relevant death benefit" for proposed s 150A(5) purposes, provides that being an "active member" of the scheme is required and that this has the same meaning as in section 151(2) of the Finance Act 2004 – i.e. *"a person is an active member of a pension scheme if there are presently arrangements made under the pension scheme for the **accrual of benefits** to or in respect of the person."*⁴ We would highlight that in DB pension schemes (whilst it may not be an obvious or commonplace occurrence), active service DB death benefits are not always linked to *accrual*.

To give an example, Member A dies whilst in service of their employer. Their DB benefits *ceased accrual* when the scheme moved to DC in 2022. However, they have remained in continuous service with the employer and their DB benefits include a salary link to current remuneration. Given this, it is unclear under the current definition that any subsequent benefits would remain free of IHT considerations. As such, we would suggest consideration should be given to amending the legislation to explicitly exclude these death-in-service benefits, in line with the policy intention behind the clause.

We would suggest further consideration should be given towards amending the proposed legislation to ensure that survivor's pensions purchased from defined contribution funds at the point of death in service are subject to the same IHT exemption as defined benefit survivor pensions paid in the same circumstances.

Clause 3

We note that clause 3 of the draft legislation proposes a new section 226A to the 1984 Act. This new clause would allow a pension scheme administrator (PSA) to decline to pay the IHT on a pension beneficiary's share of the pension if the IHT is less than £4,000. We interpret the intention behind this as being to save PSAs from an administrative burden.

However, we would highlight that this instead potentially places both an administrative and financial burden onto the beneficiary. The beneficiary will suffer income tax on the pension paid to him and will then have to recover that from HMRC. We consider it potentially unreasonable and disproportionate to allow an organisation already familiar with pensions taxation to escape an administrative

³ [Draft Finance Bill Measures](#)

⁴ [Draft Finance Bill Measures](#)

burden by instead placing an even more onerous burden onto less knowledgeable or capable individual beneficiaries.

Furthermore, we would welcome clarity on where the responsibility will lie for advising the pension beneficiaries of the possibility of issuing a section 226A notice and the tax implications of their choosing or declining to do so.

We consider that the proposed section 226A(8) of the 1984 Act in clause 3 of the draft legislation is unclear. We interpret this clause as allowing a beneficiary who issues a section 226A notice to the PSA as being able to recover any IHT which has to be refunded even if that tax has been paid by the personal representatives. We presume the intention is that where a repayment is due because of a change in the estate's circumstances (Deed of Variation etc) the beneficiary can reclaim directly the tax which the PSA paid in terms of the notice. However, as drafted, the wording appears to allow the pension beneficiary to recover tax which was in fact paid by the personal representative. For example, where a personal representative has paid the tax in order to meet the 6-month payment deadline, the pension beneficiary may have also independently issued a section 226A notice so that both the estate and the PSA have paid the tax. This provision appears to allow the beneficiary to "get in first" and claim the repayment due to the personal representatives.

Further to our previous points, where a beneficiary has paid the tax via a section 226A notice and the tax liability changes so that a repayment is due, the repayment received by the beneficiary is treated as taxable pension income. We understand that this is to prevent the beneficiary from receiving the repayment where they wouldn't have been able to withdraw the funds from the pension free of income tax.

However, this mechanism would require a beneficiary who has deliberately chosen to use the section 226A route to avoid having to register for self-assessment, to register anyway. We would welcome clarity from HMRC on whether they would advise the individual that the repayment counts as untaxed income.

We also consider it appropriate that the scheme administrator should only be liable for interest that accrues on the amount specified in a section 226A notice as a result of late payment. We do not consider it appropriate that the scheme administrator be liable for any interest that predates the notice or for any item not specified in the notice.

We also note the proposed timeline in section 226A(5) requiring the scheme administrator to pay any tax within 3 weeks beginning with the day on which it receives the beneficiary's notice. We suggest consideration be given to changing this to a timeframe of 20 business days, to allow flexibility.

Clause 4

We would express some concern around the provisions of clause 4 concerning the implications for executors.

We would observe that under clause 4(2) of the draft legislation, the clause stating “the vestee must repay the amount to the personal representatives” ignores the practicalities of extracting payment from an individual who may or may not still be in possession of the funds. Where the estate beneficiaries and the pension beneficiaries are different individuals, this is effectively mandating Person A (the Executor) to pay Person B’s (the pension beneficiary) tax liability out of Person C’s (the estate beneficiary) money. Person A is then required to use their own resources to pursue repayment from Person B while fending off claims from Person C.

We note that this requirement is broadly similar to how tax on failed potentially exempt transfers (PETs) are treated, but we are concerned that the circumstances in which this will be required are being expanded. It is difficult to see how an Executor is expected to balance the conflicting duties. Faced with a choice between paying a tax liability on behalf of a pension beneficiary to whom they owe no duty or leaving the liability outstanding and risking action by HMRC it is not always going to be clear which is the prudent action which should be taken to fulfil the duty owed to the estate beneficiaries.

We are concerned that the provisions in the clause 4 may inadvertently exacerbate disputes between executors and beneficiaries, especially in cases where the pension beneficiary is not a close family member. This could lead to increased litigation, placing further strain on the probate process. We recommend that HMRC provide clearer guidance on how executors should prioritise their duties in such scenarios to mitigate potential conflicts.

Clause 6

We would also highlight that the provisions under clause 6 of the draft legislation that propose allowing pension beneficiaries to reclaim income tax on pension monies used to fund IHT potentially impose a difficult timeframe. The proposed section 567B of the Income Tax (Earnings and Pensions) Act 2003 provides that, where the IHT is initially paid by the personal representatives, in order to claim the deduction the personal representatives must have “passed on the burden of the payment to the beneficiary” before the following 31 January. To “pass on the burden” the beneficiary must either reimburse the personal representatives or the personal representatives must pay a sum due to the beneficiary from the estate (which is then reduced by the amount of the IHT paid on the beneficiary’s behalf). If the pension beneficiary receives the pension as a taxed lump sum on 31 March 2028, in order to reclaim the income tax deducted at source, then by 31 January 2029 either (a) they will have to pay the personal representatives back for the tax

paid on their behalf (and thus have paid up to 40+% income tax *and* 40% IHT until the income tax repayment comes through); or (b) the estate will have to be in the process of making distributions to beneficiaries. If the available deduction isn't fully taken up in year 1 it can be carried forward and used against taxable pension income in future years but a beneficiary who takes a full lump sum in year 1 might not have any other taxable pension income until his own pension kicks in, potentially decades in the future.

To address the administrative challenges highlighted throughout the draft legislation, we suggest that HMRC consider introducing a dedicated online portal for pension scheme administrators and beneficiaries to report and manage IHT liabilities on pension funds. This could streamline the process, reduce errors, and provide real-time updates on tax calculations, thereby alleviating some of the burdens on both parties.

Reforms to agricultural property relief and business property relief

We previously commented on HMRC consultation: *Reforms to inheritance tax reliefs: consultation on property settled into trust*.⁵ The proposed IHT reforms to Agricultural Property Relief and Business Property Relief will have a number of impacts, particularly in relation to trusts. These reforms do create a number of complexities and possible unintended consequences. We have no specific comments on the legislation as proposed and refer to our previous comments.⁶

⁵ [Reforms to inheritance tax reliefs: consultation on property settled into trust](#)

⁶ [Reforms to inheritance tax reliefs: consultation on property settled into trust](#)



For further information, please contact:

Reuben Duffy
Policy Team
Law Society of Scotland
DD: 0131 476 8150
reubenduffy@lawscot.org.uk