

Explained: Why your pension could become liable for Inheritance Tax

Next year, a significant change to how pensions are treated when calculating Inheritance Tax (IHT) could mean more families become liable for the tax. Here's what you need to know to understand if your estate could be affected and how you might mitigate a potential bill.

Currently, pensions are usually outside your estate for IHT purposes. As a result, your pension might provide a tax-efficient way to pass on wealth to your loved ones.

This will change on 6 April 2027, when most unused pension funds and pension death benefits will be included in IHT calculations.

According to [HMRC](#) (25 November 2025), the changes mean around 10,500 estates will become liable for IHT where previously they would not have been. In addition, it's estimated that around 213,000 estates will now face a higher IHT bill.

Even if you have an existing estate plan in place that considers IHT liability, it may be worthwhile reviewing it in light of the changes.

The Inheritance Tax nil-rate band is £325,000 in 2026/27

To understand whether you'll be affected by the IHT changes, you need to start with when you pay IHT.

Roughly 1 in 20 estates are liable for IHT, and if the total value of your estate, which includes property, savings, investments, and personal possessions, is under certain thresholds, no IHT will be due.

In 2026/27, the nil-rate band is £325,000. If the value of your estate is below this threshold, it won't be liable for IHT.

In addition, the residence nil-rate band is £175,000 in 2026/27. Most estates can use this allowance if they leave their main home to a direct descendant. However, the residence nil-rate band may taper if your entire estate is worth more than £2 million.

If you're married or in a civil partnership, you can pass on your entire estate to your partner without the assets being liable for IHT, and you can also pass on unused allowances. As a result, a couple planning together may be able to pass on up to £1 million before IHT is due.

While the threshold may seem high, once you factor in large assets, such as your pension or property, it may be easier to exceed it than you expect.

Furthermore, the IHT thresholds are frozen until at least April 2031. So, if the value of your assets rises, your estate might be pushed past the IHT threshold without you realising.

The good news is that there are often steps you can take to mitigate an IHT bill, including when the rules change and your pension is added to the calculations.

3 ways you might mitigate an Inheritance Tax bill on your pension

1. Spend your pension

Perhaps the simplest way to avoid paying IHT on your pension is to spend it. After working hard to save for this chapter of your life, you could find you're in a position to make some indulgent purchases, from exotic holidays to golfing equipment.

Remember that your pension might need to provide an income for the rest of your life, and it's not uncommon for a retirement to span several decades. So, it's important to balance spending now with long-term financial security, which a financial plan may help you achieve.

2. Purchase an annuity

If you have a defined contribution pension, you can access it in several ways. One option that could be effective from an IHT perspective is purchasing an annuity.

An annuity is a financial product you buy that then provides an income for the rest of your life. In some cases, the income provided may increase in line with inflation or a portion may continue to be paid to your partner if you passed away first.

You can use all or part of your pension to purchase an annuity. As the money is taken out of your pension, it's effectively removed from your estate, which might reduce IHT liability. However, there is a risk that you'd pass away before getting the money back through the income.

Buying an annuity is often an irreversible decision, so it's important to weigh up all your options when accessing your pension.

3. Pass on pension wealth to loved ones during your lifetime

If passing on wealth to loved ones is important to you, you could do so during your lifetime.

Gifting wealth from a pension could support your beneficiaries and potentially reduce an IHT bill by reducing the value of your estate.

However, not all of your gifts are considered immediately outside of your estate when calculating IHT. In some cases, gifts may be included in the calculations for up to seven years after they are given; these are known as "potentially exempt transfers".

Some gifts are immediately outside of your estate for IHT purposes, making them useful if you want to mitigate an IHT bill. In 2026/27, they include:

- An annual exemption of £3,000, which can be given to one person or split between multiple people. If unused, your annual exemption can be carried forward for one tax year.
- Small gifts of up to £250 to as many people as you like, so long as you haven't used a different allowance on the same person.
- Wedding gifts of £1,000, rising to £5,000 for children and £2,500 for grandchildren or great-grandchildren.
- Regular gifts that are given from your surplus income, such as paying into your grandchild's savings account each month or helping with your family's living costs. These gifts must be

made regularly and come from your income, rather than depleting your capital. If you intend to use this exemption, it's important to keep a record, so a clear pattern can be established.

Another factor to consider is how you'll be taxed when withdrawing money from your pension. If your total income exceeds the Personal Allowance (£12,570 in 2026/27), withdrawals may be subject to Income Tax.

As a result, large withdrawals for gifts could be taxed and potentially push you into a higher tax band.

Again, it's important to consider your long-term financial security. Gifting too much could leave you in a financially vulnerable position later in life. Making gifts part of your wider financial plan could give you confidence in your finances now and in the future.

Contact us to discuss your estate plan

There are other ways you might reduce or mitigate a potential IHT bill, such as passing on wealth through a trust or leaving a portion of your estate to charity.

Please get in touch to talk about your objectives and how we could help you create an estate plan that's tailored to your needs.

Please note: This article is for general information only and does not constitute advice. The information is aimed at individuals only.

All information is correct at the time of writing and is subject to change in the future.

HM Revenue and Customs' practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested.

The Financial Conduct Authority does not regulate Inheritance Tax planning or trusts.

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