Explanatory Note

Clause 45: Inheritance tax: pension drawdown funds

Summary

1. This measure introduces an exemption so that an inheritance tax (IHT) charge will not arise where a person has failed to exercise their rights to draw designated funds from a drawdown pension fund or a flexi-access drawdown fund during their lifetime and so has left unused funds when they die.

Details of the clause

2. Subsection 1 amends Inheritance Act (IHTA) 1984.

3. Subsection 2 amends the heading for sections 10 to 17, which deal with dispositions that are not transfers of value for IHT purposes, to include a reference to deemed dispositions.

4. Subsection 3 makes a minor consequential amendment to the definition of "entitled" in section 12(2G) to include when a beneficiary becomes entitled to income withdrawal as a result of new section 167(1A) of Finance Act 2004.

5. Subsection 4 inserts new section 12A into IHTA1984.

Section 12A: Pension drawdown fund not used up: no deemed disposition

6. New section 12A applies where a person has become entitled to a drawdown pension fund or flexi-access drawdown fund but has omitted to exercise their right to draw down all of the designated funds in their lifetime and as a result there are undrawn funds at the time they die in that drawdown fund.

7. Subsection (1) provides that a person who omits to exercise a right to draw down, or use up, their drawdown funds during their lifetime is not to be treated as making a disposition. This means that the value of their estate is not reduced by the omission to draw down all the funds, so the omission is not treated as a transfer of value and is therefore not liable to IHT.

8. Subsection (2) clarifies the meaning of a drawdown fund for the purposes of subsection (1) in relation to registered pension schemes.

9. Subsection (3) clarifies the meaning of a drawdown funds for the purposes of subsection (1) in relation to similar "corresponding schemes" that are not registered pension schemes.

10. Subsection (4) defines "corresponding schemes", "money purchase arrangement" and the various types of drawdown funds.

11. Subsection 5 of the clause sets out when new section 12A of IHTA will apply. For member's

and dependants' drawdown pension funds, the provisions will have effect where a person with the unused funds dies on or after 6 April 2011 and the provisions will be treated as coming into force on 6 April 2011. For flexi-access drawdown funds, which came into existence for tax purposes from 6 April 2015, the date that new section 12A comes into effect and is treated as coming into force is modified to take into account that later commencement date.

12. Subsection 6 provides for the extension of the normal time limit for a claim to repayment of any IHT or interest overpaid as a result of the retrospective commencement of new section 12A.

Background note

13. An IHT charge may arise if a person reduces the value of their estate by failing to exercise rights they have over property. This general rule does not apply to funds held in pension schemes to which a person fails to become entitled. When a person takes their pension benefits, or elects to draw down all or part of their pension, they become entitled to those funds. Having become entitled, if they fail to exercise their rights over those drawdown funds leaving funds undrawn on their death, the general rule applies and an IHT charge may arise.

14. From April 2015 the government introduced changes to the pension tax rules that allowed more people to flexibly access their money purchase pension funds from age 55. This flexibility and an increase in drawdown arrangements means the IHT charge could potentially apply to more people when they leave undrawn funds in their pension scheme when they die. It was not intended that an IHT charge should arise in these circumstances and this measure ensures that it does not do so.

15. If you have any questions about this change, or comments on the legislation, please contact Danka Wigley on 03000 585277 (email: danka.wigley@hmrc.gsi.gov.uk).