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Zurich Wealth Protection

Pension Inheritance Tax (IHT) protection

A tax-efficient way for a client to cover their Inheritance Tax (IHT) liability and leave a legacy gift for their family, using a Whole of Life policy funded by income taken from surplus pensions that will be liable to IHT from 6th April 2027

What is the IHT position?

From 6th April 2027, unused pension funds will be included in the value of a person's estate and therefore liable to IHT. Their personal representatives (PRs) will be expected to pay the IHT arising on inherited pensions within six months.

It may be possible for the PRs to direct pension scheme administrators (PSAs) to withhold 50% of a deceased's taxable pension benefits for up to 15 months to **pay the IHT arising on itself**. However, this has several potential drawbacks:

- **The pension can only be used to pay the IHT directly arising on itself - it can't be used to pay any IHT due on the rest of the estate**
- **It relies on the PSAs not only having the right processes in place to be able to pay the IHT, but also to do so without delay**
- **It may not be possible to sell certain pension assets, such as commercial property or unquoted shares, for many months or even years**

Crucially, regardless of the reason, if the IHT isn't paid within six months then late payment interest will start to accrue, which may cause the PRs significant liquidity problems.

Certainty, liquidity & tax-efficiency

Historically a pension has been one of the most tax-efficient vehicles for people to pass on wealth to their family, but that will no longer be the case. There is however an alternative solution that can replace that former tax-efficiency.

Instead of leaving their surplus pensions to just potentially saddle their PRs with a liquidity problem, one option is for a client to take an income from them to **pay the premiums on a Whole of Life policy**. Consider the advantages of this:

- **The income could be used to fund cover for the IHT liability on the whole estate, not just that arising within the pension**
- **When written in trust, a Whole of Life policy can be paid to the beneficiaries without delay and free of IHT – providing certainty and liquidity**
- **The premiums should qualify as 'normal expenditure out of income'*, and therefore will actually reduce the IHT liability**

An additional benefit of this arrangement is, because the sum assured will remain level while the premiums paid reduce the client's IHT liability*, the balance remaining at death could be used to provide **a tax-efficient legacy gift** for their family.

Funding the Whole of Life policy

The Whole of Life premiums could be funded by regular withdrawals from a flexi-access drawdown, or by income from an annuity**. A further advantage of using an annuity is that in many cases the purchase value will be immediately exempt from IHT.

*Normal expenditure out of income

Life insurance premiums will be exempt transfers for IHT purposes as '**normal expenditure out of income**' provided they are paid out of the client's income (rather than capital), form part of their regular spending pattern and do not compromise their normal standard of living.

** Back-to-back arrangements

If an annuity is to be purchased to provide the income to fund the Whole of Life policy, it is important that, to avoid falling foul of HMRC's **'back-to-back' rules**, the annuity and insurance policy must not be linked, e.g. bought from different providers. Zurich does not offer annuities.

The greater the amount spent from the pension to fund the Whole of Life cover, the greater the amount that will be left to provide a legacy gift - though the amount of cover we can offer will be limited to £2m or the client's total IHT liability if higher.

You can use our **Whole of Life calculator** to demonstrate the value of a Whole of Life policy by modelling the return it will provide at any given assumed age of death.

Contact us

For more information about this or any of our other Wealth Protection solutions please contact your usual Zurich contact. Further information and technical resources are also available on the **Wealth Protection hub** on our website.