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UK Inheritance Tax Reform: a matter of life (policies) and death

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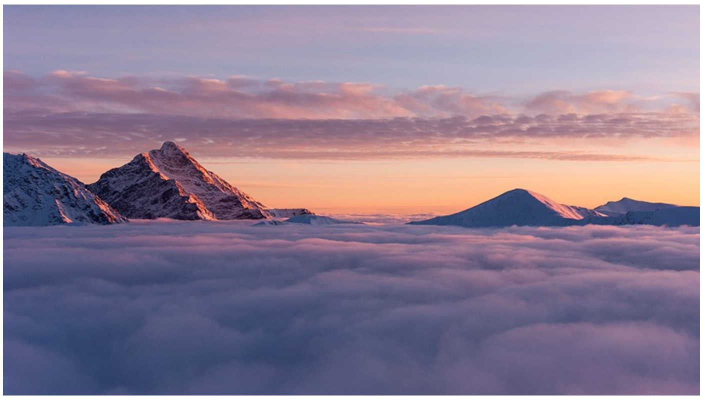

In the first of our series reviewing the reports on the IHT system by the Office of Tax Simplification (the '**OTS**') and the All-Party Parliamentary Group on Inheritance & Intergenerational Fairness, (the '**APPG**') we focused on the reforms particularly relevant to private individuals. In this Part 2 of our review, we will explain how the differing approaches of the OTS and the APPG might impact the life insurance and pensions industries.

Life policies

The APPG's radical proposal for an immediate tax charge on outright gifts (in excess of an increased £30,000 annual allowance) would have a profound impact on the term insurance industry. Many term insurances are currently taken out precisely to cover the risk of a 'potentially exempt transfer' (known as a PET) becoming chargeable if the donor dies within 7 years of the gift. Other term insurance products are also postulated on the expectation of lifetime planning taking place within a set number of years (for instance as soon as the children are old enough to receive the assets outright).

By contrast, the position taken by the OTS would not impact the term policy industry in the same manner. The recommendation is that term policies, should be exempt from IHT, whether or not they are written in trust. This seems sensible as many policies are taken out specifically to cover IHT and it is unnecessarily cumbersome to have to create a trust to ensure that the policies are not themselves subject to IHT (although a trust may be useful for other purposes).

Pensions

As for term life insurance policies, the OTS considers it anomalous that certain pension policies are within an individual's estate for IHT purposes if not written into trust whereas other comparable pension savings which are not written into trust can still be paid free of IHT. It also identified other areas of complexity in relation to the interaction of pensions and IHT, particularly regarding pension transfers in the two years before death. The OTS welcomes HMRC's commitment to update its guidance on this point in light of recent case law, but the OTS considers that a wider review of the tax system and pensions is necessary, which suggests it may have more radical recommendations relating to the taxation of pensions in future.

The APPG on the other hand recommends bringing the IHT treatment of pensions into line with its wider proposal to overhaul the IHT regime such that the value of pension funds left on death should be taxed at a flat rate of 10% (or 20% depending on the value of the estate, including the pension pot), unless passing to the surviving spouse or civil partner. This would be a significant change given pensions have to date always remained outside the IHT net and it is also not clear how this would interact with the current income tax rules applicable to pension death benefits, which typically apply following the death of the pension member after age 75.

Having looked at the potential impact here on the pensions and life insurance industries, and rates, and reliefs in Part 1 of our series, our final installment of this series will look at what inspirations may be drawn from European equivalents of the IHT system.

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