Office for Budget Responsibility

30 January 2025

Supplementary forecast information release

Costing of applying inheritance tax to pension wealth

1.1 The OBR is releasing this information following a request for further detail in respect of the costing of applying inheritance tax to all pension wealth that is transferrable at death, in our October 2024 *Economic and fiscal outlook* (*EFO*). We will, as far as possible, meet any requests to release supplementary forecast information where this will improve the quality of public debate on the public finances. Our full release policy is available on our website.

1.2 This release briefly describes the measure, sets out the data sources and modelling used to estimate the costing, and discusses the main sources of uncertainty around this central estimate, following the OBR's policy costings process.[1] As set out in the *Charter for Budget Responsibility*, the government is responsible for producing all policy costings. In the case of tax policies the costings are typically produced by HMRC. The OBR's role is to provide independent scrutiny and certification of whether the government's policy costings are reasonable and central.[2]

Policy description

1.3 Inheritance tax (IHT) is levied on the estate of an individual upon death. Under current policy, unused pension wealth and death benefits are excluded from the value of the estate in most circumstances. From April 2027, the value of the estate will include any unused pension wealth that has an inheritable value in the form of uncrystallised defined contribution (DC) pensions, crystallised DC pensions not invested in annuities, and lump sum death benefits from defined benefit (DB) pensions.[3] By design, other DB pension benefits and annuitised DC pensions are generally not inheritable and will not be liable for IHT.[4]

Data

1.4 Under current rules estates are not, in general, required to report pension wealth to HMRC for IHT purposes, meaning HMRC does not hold administrative data on the size of the tax base. This costing uses multiple data sources to model baseline IHT revenue, estimate the size of the tax base, and calculate the static impact of changing the wealth in scope for IHT:

- Outturn IHT administrative data from 2021-22, the latest available, is used to model baseline IHT revenue and non-pension wealth in scope for IHT.[5]

[1] See our *Briefing paper No.6: Policy costings and our forecast*, March 2014.
[2] This means that the full datasets underpinning tax policy costings are generally held by HMRC. Therefore, requests for access to any datasets not available at the sources referenced in this note should be directed to HMRC.
[3] Uncrystallised pensions are pension savings which have not been accessed by the individual. Crystallised pensions are pension savings which have been cashed out to purchase a drawdown product or an annuity.
[4] For more information on the policy, see HMRC, *Technical consultation - Inheritance Tax on pensions: liability, reporting and payment*, October 2024.
[5] See HMRC, *Inheritance Tax liabilities statistics: commentary*, July 2024.

- ONS Wealth and Assets Survey (WAS) data from 2018-20 (Round 7) is used to estimate the size of the tax base.[6] Reported pension assets are grown in value to 2021-22 to bring them in line with IHT administrative data, using outturn equity prices growth.

- Financial Conduct Authority (FCA) retirement income market data from 2013 and 2017 is used to estimate crystallised pension wealth liable for IHT.[7]

1.5 To estimate the size of the tax base, pension wealth estimates are imputed onto IHT administrative data. WAS data is used to calculate the probability of an individual having any pension wealth, conditional on a set of characteristics (Table 1.1) available in both WAS and IHT administrative data, and the average value of crystallised and uncrystallised pension wealth among those with any pension wealth. These WAS calculations are then used to impute estimates of crystallised and uncrystallised pension wealth on observations in IHT administrative data. Observations are randomly assigned pension wealth conditional on their characteristics.[8]

1.6 WAS data does not contain information on the type of crystallised pension product an individual receives income from. This is important because drawdown products from DC schemes are transferrable at death and therefore liable for IHT under the new policy, but annuity products are not.

1.7 To proxy crystallised pension wealth liable for IHT under the new policy, the costing uses FCA data to estimate drawdown products sold relative to the total value of the pension market. Using market shares from before and after 2015 pension flexibility reforms,[9] shown in Table 1.1, the costing assumes 40 per cent of crystallised pension wealth for individuals aged 60 or below is within scope of this measure, and 4 per cent otherwise.[10] The age threshold decreases each year of the forecast period to reflect an increasing share of pension wealth within scope of this measure, as individuals retiring in future years are more likely to have drawn down wealth after the 2015 reforms. Crystallised pension wealth, imputed on IHT administrative data from WAS, is adjusted using this proxy to produce a final dataset of death estates with pension wealth in scope for taxation in each year of the forecast.

[6] See ONS, *Household total wealth in Great Britain: April 2018 to March 2020*, January 2022.
[7] FCA, *Retirement income market study: Interim Report*, December 2014; FCA, *Retirement income market data 2018*, September 2018.
[8] Observations are randomly assigned pension wealth equal to either zero or the WAS average, with probability equal to the corresponding WAS probability. For example, 92 per cent of married, male individuals aged between 70 and 79 who have an estate excluding pension wealth estimated between £1 million and £2 million had any pension wealth in WAS. Among those with any, the average pension wealth was £109,400. Individuals with the same characteristics in IHT administrative data have pension wealth randomly imputed, equal to £109,400 with probability 92 per cent and zero with probability 8 per cent.
[9] 2015 pension flexibility reforms allow individuals to purchase drawdown products at their marginal income tax rate, where previously they would have faced a 55 per cent tax charge after withdrawing the first 25 per cent tax free. This increases the incentive to purchase a drawdown product instead of an annuity (see Table 1.1).
[10] In 2013, just 9 per cent of the value of pension products sold from DC pension schemes were drawdown products, equal to 4 per cent of the entire pension market (9 per cent of 46 per cent, the share of all pensions in payment paid out of DC pension schemes). In 2017 this increased to 87 per cent of the value of products sold from DC schemes, equal to 40 per cent of the entire pension market (87 per cent of 46 per cent).

Modelling

Static costing

1.8 The tax base for this measure consists of estates whose IHT liability is affected by bringing pension wealth which is transferrable at death into the value of the estate, either paying more IHT, or being brought into paying IHT as a result of the changes.

1.9 The baseline for the costing is the pre-measures IHT forecast, taken from HMRC's IHT microsimulation model (Table 1.1). The model estimates the population of estates being passed on using the IHT administrative data from 2021-22 mentioned above, whose number and value are forecast for future years using ONS population projections, and the equity price, house price and household cash deposit determinants from the OBR's economic forecast (Table 1.2), amongst others. The current IHT rules and thresholds are applied to estimate the IHT charges on estates, and time-shifted to account for IHT receipts.[11]

1.10 The static costing of this measure amends the IHT model to include the value of pension wealth which is transferrable at death in the value of the estate from April 2027. Pension wealth is grown over time using the equity prices determinant from the OBR's economic forecast (Table 1.2). The results of this amended modelling, once time-shifted to account for when HMRC receives these revenues, are compared to the baseline estimate of IHT receipts, and the increase in IHT revenue constitutes the static costing.

Behavioural response

1.11 The behavioural response is highly uncertain because individuals have a wide range of tax planning options which could be used to respond to the policy change. Individuals can choose to prioritise consuming their pension wealth to fund their retirement and to avoid any additional tax liability when they pass away, rather than leaving this wealth untouched for tax-planning purposes. With any remaining unused wealth, individuals could then respond by using other reliefs and allowances, such as: reallocating investments into assets which qualify for agricultural or business property relief;[12] increasing gifting while younger;[13] increasing charity bequests; or adjusting their will to leave as much wealth as possible to a surviving spouse or civil partner, which is exempt from IHT.

1.12 The magnitude of behavioural impacts has been modelled via a top-down adjustment to the static costing. The top-down approach is in line with other certified IHT costings and reflects the relative lack of academic evidence on the elasticity of IHT receipts to policy changes. The modelled behavioural impacts are dependent on the individual's marital status at the time of death:

- To account for a likely significant increase in the use of spouse exemption by married estates alongside other behavioural channels, the additional IHT yield from married

[11] For more information on the OBR's IHT forecast, see OBR, *Forecast in-depth: Inheritance tax*, April 2024.
[12] The October 2024 Budget also included changes to agricultural and business property relief. See OBR, *Supplementary forecast information release: Costing of changes to agricultural and business property relief*, January 2025.
[13] The effects of this will fall outside the forecast window, as gifts must be made at least seven years before the death of the giftor. This may not be possible for some individuals affected by the measure.

estates in the static costing has been scaled down using an increasing attrition assumption. This rises from 85 per cent in 2027-28 to 95 per cent at the forecast horizon.

- To account for other tax planning channels described above, the additional IHT yield from unmarried estates in the static costing has been scaled down using an increasing attrition assumption, which rises from 10 to 20 per cent at the forecast horizon as individuals have more time to restructure their affairs. Following increased consumption of pension wealth, greater use of other reliefs and greater bequests to charity are likely to be the main behavioural channels in the medium term.

Interactions with other measures

1.13 Changes to agricultural and business property reliefs and the extension of the freeze to the nil-rate band and residence nil-rate band to 2029-30 have a small upward impact on this costing because they reduce the tax-free allowances available to estates. No other measures affect this costing.

Table 1.1: Key parameters

Parameter	Value	Description
IHT tax rates (per cent)		
Standard rate (previous)	0	Tax rate on pension wealth transferrable at death under previous policy.
Standard rate (current)	40	Tax rate on pension wealth transferrable at death under new policy.
Characteristics for pension wealth imputation		**Grouping**
Gender	-	Male; female.
Age band	-	<20; 20-39; 40-49; 50-59; 60-69; 70-79; 80+.
Marital status	-	Married/civil partnership; other (e.g. widowed, single, divorced).
Estate size excluding pension wealth[1]	-	<£250k; £250k-<£500k; £500k-<£750k; £750k-<£1m; £1m-<£2m; £2m+.
Tax base		
Estates with pension wealth	213,000	Number of estates with inheritable pension wealth in 2027-28.
Average pension wealth (£)	54,900	Average inheritable pension wealth in 2027-28.
Affected estates	49,000	Estates where IHT payable increases in 2027-28.
of which:		
Previously taxpaying	38,500	Estates previously liable for IHT, now paying more.
Previously non-taxpaying	10,500	Estates not previously liable for IHT, now paying any.
Drawdown products relative to all pension products pre-2015 reform[2]	4	Value of drawdown products sold from DC pension schemes as a share of all pension products sold in 2013.
Drawdown products relative to all pension products post-2015 reform[3]	40	Value of drawdown products sold from DC pension schemes as a share of all pension products sold in 2017.
Non-OBR determinants		
ONS principal population projections	-	Number of estates projected in line with deaths in the UK.
Behavioural assumptions (per cent)		
Married estates attrition	85	Loss of static yield from married estates in 2027-28.
Unmarried estates attrition	10	Loss of static yield from unmarried estates in 2027-28.
Annual increase in attrition (ppts)	+5	Increase in attrition assumption per year.

[1] Estate includes net property wealth, net physical wealth and net non-property wealth.

[2] FCA, *Retirement income market study: Interim Report,* December 2014.

[3] FCA, *Retirement income market data 2018,* September 2018.

Source: FCA, OBR

Table 1.2: OBR determinants used in costing

	Forecast					
	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Pre-measures IHT forecast (£ billion)	8.3	8.6	9.2	10.0	10.7	11.3
Equity prices (FTSE all-share index)	4,537	4,742	4,918	5,092	5,271	5,461
House price index (Jan 2015=100)	149.6	150.9	154.0	158.3	163.0	167.9
Household currency and deposit assets (£ billion)	2,227	2,292	2,361	2,437	2,519	2,607

Note: The difference between the pre-measures and post-measures IHT forecast is the direct effect of measures, such as applying IHT to pension wealth, plus the indirect effect of the policy package on determinants that affect the IHT forecast.

Source: OBR

Final costing

1.14 The central estimate for the costing is an increase in revenue of £1.5 billion by 2029-30, with the behavioural response reducing the static yield by around 43 per cent. There are upside and downside risks to the degree of attrition in the long term, and the yield from this measure is not likely to reach a steady state for several decades. In the long term, the main upside risk is the degree to which 2015 pension flexibility reforms drive a continued increase in inheritable pension wealth in the future as individuals choose to invest in drawdown products. Downside risks include increased gift-giving which will mostly impact receipts beyond the forecast period. More generally, individuals tend to structure their affairs with a view to inheritance planning in their 50s and 60s, which will primarily affect the costing over the longer term. In the medium term, it is likely to be more difficult for some older individuals to quickly restructure their affairs in response to the measure.

Table 1.3: Costing of applying inheritance tax to pension wealth

	£ billion					
	Forecast					
	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Static costing	0.0	0.0	0.0	-0.9	-2.1	-2.6
Behavioural response	0.0	0.0	0.0	0.3	0.8	1.1
of which:						
Spouse exemption	0.0	0.0	0.0	0.3	0.6	0.8
Other attrition	0.0	0.0	0.0	0.0	0.2	0.3
Post-behavioural costing	0.0	0.0	0.0	-0.6	-1.3	-1.5

Note: This table uses the convention that a negative figure means a reduction in PSNB.
Source: OBR

1.15 This policy costing was assigned a 'very high' uncertainty rating.[14] The main driver of uncertainty is the behavioural response to the measure, given the range of options potentially available. This in turn adds uncertainty to the modelling of the behavioural responses. There is also very high uncertainty around the data. The costing relies on self-reported pension wealth in survey data representative of Great Britain supplemented with market data which provides a top-down judgement on inheritable crystallised pension wealth, imputed onto administrative data which is representative of death estates, a different population.

[14] See the 'Policy costings uncertainty ratings database – October 2024' spreadsheet at OBR, *Policy costings*, November 2024.