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IS THIS YOU?

Are you someone who has put a lifetime of work into building wealth and a pension, only to find that the change to the Inheritance Tax rules has come as a shock to your family's wealth? Are you now looking across all your assets, trying to understand how the different moving parts interact?

You may have spent thirty years being told to leave the pension alone, and now find it's the thing taking your estate over £2 million. This guide was written for you.

IN THIS GUIDE YOU WILL FIND

- How to take an income from your pension without walking into the 60% income tax trap, and who should consider running the pension down by drawing up to £100,000 a year.
- What the 60% Inheritance Tax trap is, why your pension now counts towards it, and a chart that shows it in one picture.
- Why five pensions are harder to run and harder to pass on than one, and which ones should be left where they are.
- What happens to your pension when you die, before and after 75, and the two routes for what is left: straight to a beneficiary, or into a Pension Legacy Trust that keeps it out of your children's estates.
- Gifts from surplus income, the exemption with no seven-year wait, and where life insurance fits for the right people.
- A worked example with the sums shown in full: one year's drawing from a £1.2 million pension, and the same £87,500 left in it until death.

Prefer a print version? For one that won't slurp up half your toner, email **info@deep-dive.co.uk** and we'll ping it through.

Reading time: about 17 minutes.

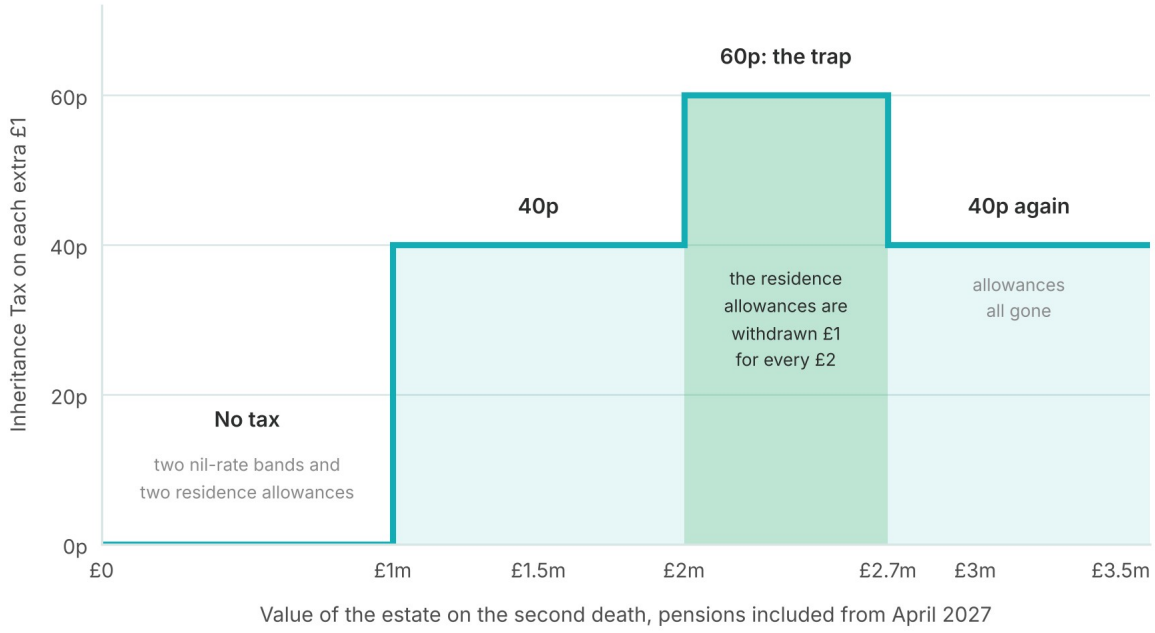
By the end of it you'll know what changes on 6 April 2027, how much to draw and in what order, what to do with the money you don't spend, and what happens to what's left before and after 75. The last page lists the seven mistakes to avoid and the nine tactics to consider, so you can decide what to do next.

WHAT IT IS

A pension is three things at once: a pot of money you need to live on, a pot where a quarter comes out tax-free and the rest is taxed as income, and, from 6 April 2027, part of your estate for Inheritance Tax when you die. For thirty years the advice was to spend everything else first and leave the pension until last, because it passed to your children without Inheritance Tax. The rug was pulled in the Budget of October 2024. For a couple with a house, some savings and a decent pension each, the pension is now often the thing that takes the estate over £2 million and into the effective 60% Inheritance Tax band, with the possibility of further income tax when the money is withdrawn by the recipient.

The 60% Inheritance Tax trap.

Inheritance Tax is 40%. On top of the £325,000 nil-rate band, each of you has a £175,000 residence allowance for leaving the family home to children or grandchildren. That residence allowance is withdrawn at £1 for every £2 the estate is worth over £2 million, so between £2 million and £2.7 million every extra £1 you leave costs 60p in tax. From 6 April 2027, pensions count towards the £2 million. This is a different trap from the 60% income tax band, which appears later in this explainer: that one applies to income between £100,000 and £125,140 in a single year, where the personal allowance is withdrawn. The first is about what you leave. The second is about what you draw.



Inheritance Tax on each extra £1 of a married couple's estate on the second death, with the home left to children or grandchildren and no earlier gifts. A single person's trap runs from £2 million to £2.35 million.

So the questions have changed. How much should you draw, and in what order? What should you do with the money you draw and don't spend? What happens to what's left when you die,

and how do you stop it being taxed again when your children die? And how do you keep up, when the rules have been rewritten five times since 2006?

This explainer goes through the ways of taking an income, why your pensions are easier to run as one, what happens on death before and after 75, the two routes for whatever is left (straight to a beneficiary, or into a Pension Legacy Trust), gifts from surplus income, and where life insurance fits.

THE QUESTIONS PEOPLE ASK

TAKING AN INCOME

Why does everyone say pensions are complicated?

Because the rules change every couple of years and each change leaves a layer behind. One set of rules for all pensions in 2006. Freedom to draw what you like from 2015. A new state pension in 2016. The lifetime allowance abolished in April 2024 and replaced with two lump sum allowances. Pensions brought into Inheritance Tax from April 2027, announced in the October 2024 Budget and now law under the Finance Act 2026. The state pension age rising to 67 between 2026 and 2028, and the earliest private pension age rising to 57 in 2028. Income tax thresholds frozen until April 2031 while the state pension rises every year, so more of it is taxed. Each one changes the answer to "how much should I draw this year". Keeping up with it is a large part of what you pay an adviser for.

What are my options for taking money out?

- **Tax-free cash.** Up to 25% of the pot, capped at £268,275, with no income tax. In one go or in slices.
- **Drawdown.** The pot stays invested and you draw what you want, when you want. Every withdrawal is taxed as income.
- **An annuity.** You hand over a lump sum and an insurer pays you an income for life.
- **Lump sums.** Each withdrawal is 25% tax-free and 75% taxed. Useful for topping up a year's income without touching the rest.
- **A defined benefit pension.** A fixed income, usually rising with inflation, from an old employer's scheme. Final salary schemes are the best known kind, but many public sector and newer schemes work the same way on a career average. There is no pot to draw from and the choices are few.

Most people over 60 use a combination: the state pension and any defined benefit pension as a floor, with drawdown, an annuity or both on top.

How is drawdown taxed?

As income, on top of everything else you receive that year. The personal allowance is £12,570. The next £37,700 is taxed at 20%, then 40% up to £125,140, then 45%. Between £100,000 and £125,140 the personal allowance is withdrawn at £1 for every £2, which makes the real rate on that slice 60%. This is the 60% income tax trap, and it has nothing to do with the Inheritance Tax one in the box above. The full new state pension is £12,548 a year, so it uses the personal

allowance almost on its own, and everything you draw from a private pension is taxed from the first pound. The first flexible withdrawal from a new drawdown plan is often over-taxed on an emergency code and reclaimed afterwards, which is one of the small indignities of the system.

How much should I draw?

For most people we see with a serious Inheritance Tax problem, more than they draw now. Leaving the pension untouched made sense when it passed to the children tax-free. From April 2027 it costs 40% Inheritance Tax, and if you die after 75 your children pay income tax on what's left. For a child paying 40% income tax, 36p of every pound reaches them; for one paying 45%, 33p. If the estate is in the 60% Inheritance Tax band, 22p. Against that, drawing the money now and paying 40% looks reasonable, and paying 20% looks cheap.

For clients whose pension is large enough to need running down, the sensible ceiling is £100,000 of total income a year, because that is where the 60% income tax band starts. Draw up to it, spend what you want to spend, and give the rest away as regular gifts from income, which leave your estate the day you make them. The aim is to run the pension down over your lifetime at 20% and 40% rather than hand it over at 60% Inheritance Tax or more. The plan has to be tested with cash flow modelling against living to 100 and against a bad market in year two, because a pension you've emptied is no use to you at 95.

An example.

John is 67, with a state pension of £12,500, £1.2 million in a SIPP and spending of about £50,000 a year. He draws £87,500 from the pension, taking his total income to £100,000. Income tax for the year is about £27,400, leaving £72,600. He spends his £50,000 and gives the remaining £22,600 to his two children as regular gifts from surplus income, outside his estate at once. Of the £87,500 he drew, about £60,000 reached him after tax. Had he left that £87,500 in the pension and died after 75, with Inheritance Tax at 40%, his children would have received between £29,000 and £42,000 of it, depending on their own tax rates.

The working, for one year:

John draws the money	
State pension	£12,500
Drawn from the SIPP	£87,500
Total income	£100,000
Less the personal allowance	£12,570
Taxable income	£87,430
Tax at 20% on the first £37,700	£7,540
Tax at 40% on the remaining £49,730	£19,892
Income tax for the year	£27,432
Income after tax	£72,568
Spending	£50,000
Surplus given to the children, outside the estate at once	£22,568
Of the £87,500 drawn, John keeps	£60,068

The same £87,500 is left in the pension	Child paying 20% tax	Child paying 40% tax	Child paying 45% tax
John dies after 75	£87,500	£87,500	£87,500
Inheritance Tax at 40%	£35,000	£35,000	£35,000
Pension passes to the child	£52,500	£52,500	£52,500
Income tax at the child's own rate when they draw it	£10,500	£21,000	£23,625
The child receives	£42,000	£31,500	£28,875

Should I take my tax-free cash?

Only with a plan for it. Up to 25% of the pot, capped at £268,275, comes out free of income tax. The moment it leaves the pension it sits in your bank account and counts for Inheritance Tax. From April 2027 it counts inside the pension too, so the old reason for leaving it there has gone. There are three sensible uses: spend it on something you were going to spend on anyway; give it away, which starts the seven-year clock; or take it in slices over several years to top up your income without pushing yourself into a higher band. The common mistake is to take the lot because you can, put it in a savings account, pay tax on the interest and then 40% on the way out of your estate. There is no deadline for taking it: the tax rules let you take tax-free cash after 75, as long as you have allowance left. A handful of older schemes insist that benefits are taken by 75, which is their rule rather than the taxman's, and one more reason to read the small print.

Should I buy an annuity?

Rates are far better than they were five years ago. At the time of writing, £100,000 buys a healthy 65-year-old around £8,200 a year for life, level, or about £5,600 a year rising with inflation. At 70 the level figure is around £9,000. Poor health gets a higher rate, which is the one occasion it pays. In favour: certainty, no investment decisions, no market to worry about, and the capital stops being an Inheritance Tax problem because it belongs to the insurer. Against: the income dies with you unless you pay for a guarantee or a spouse's pension, a level income buys less every year, and you can't change your mind. For many of our clients the answer is a mixture: enough guaranteed income from the state pension, any defined benefit pension and perhaps an annuity to cover the bills, with the rest in drawdown for flexibility and for gifting.

I'm still working. Does that change anything?

Once you take taxable income from a pension flexibly, the amount you can pay in each year drops from £60,000 to £10,000. Taking tax-free cash alone doesn't trigger it. If you or your employer are still contributing, the order in which you do things matters, so talk to someone before the first withdrawal.

TIDYING UP

I've got five pensions. Does it matter?

From 2027, more than it ever did. Each pot has its own nomination form, its own tax code, its own rules about drawdown (some older schemes don't offer it, so you'd have to transfer before you could draw flexibly), and its own paperwork for your attorney if you lose capacity and for your executors when you die. Your executors will have to get a valuation from every scheme and sort out who pays the Inheritance Tax on each, inside the same six-month deadline as the rest of the estate. The Pensions Policy Institute put lost pension pots at £31.1 billion in April 2026, across 3.3 million pots, and a pot is easier to lose when it is one of several. One pension on one platform means one nomination, one income plan, one set of statements and one phone call for whoever has to pick it up after you. We're independent, with no panel, and we negotiate preferential charges on the platforms we favour.

Is there anything I shouldn't consolidate?

Yes, and it needs reading before anything moves. A defined benefit pension stays where it is in nearly every case. Transferring one worth over £30,000 requires expensive and highly technical advice by law, and that advice usually ends in a recommendation not to transfer.

Some older plans carry a guaranteed annuity rate of 9% or 10%, which no insurer will offer you today. Some have tax-free cash protected above 25%. With-profits funds can charge an exit penalty. A scheme your employer still pays into should keep receiving the contributions. Part of the job is reading the small print of each plan and leaving alone the ones that deserve it.



WHAT HAPPENS WHEN YOU DIE

What happens to my pension when I die?

Until 5 April 2027, it passes outside your estate. If you die before 75 your beneficiaries can take it free of income tax, up to a lump sum death benefit allowance of £1,073,100. After 75, they pay income tax at their own rate on what they draw.

From 6 April 2027, it counts for Inheritance Tax. Left to your husband, wife or civil partner it is exempt, like everything else you leave them. Left to anyone else it is taxed at 40%, or 60% if the estate is in the Inheritance Tax trap, and the income tax rules above still apply to what's left if you were over 75. Your executors are responsible for the tax, and they can ask the scheme to pay it straight to HMRC out of the pension so your children aren't finding the money elsewhere. A few old contracts pay the death benefit to your estate rather than to beneficiaries, which was a problem before 2027 and remains one.

Who decides who gets it?

The scheme's trustees, guided by your nomination form, sometimes called an expression of wish. They are not bound by it, but they follow it in nearly every case. Most of the planning in this explainer is carried out on that form, and it is the document most people haven't looked at since they joined the scheme. Each pension has its own, which is another reason to have one pension.

Why does the age of 75 keep coming up?

Because the income tax treatment of what you leave changes on your 75th birthday. Before it, whoever inherits pays no income tax on the pension. After it, they pay at their own rate. From April 2027 Inheritance Tax applies either side of 75, so the question of what to do with what's

left has two answers depending on age. Your 75th birthday has no effect on your own tax-free cash or on how your withdrawals are taxed while you are alive. Before 75, a lump sum can go into a trust free of income tax, within the £1,073,100 lump sum death benefit allowance. After 75, a lump sum paid into a trust is taxed at 45% on the way in, which the beneficiaries can partly reclaim later but is a poor start, so it is usually better for the money to go to a person, who keeps it in a pension and draws it at their own rate.

What is beneficiary drawdown?

The person inheriting keeps the money inside a pension in their own name instead of taking it as a lump sum. Nothing is taxed until they draw it, nothing at all if you died before 75, and it keeps growing without tax in the meantime. The drawback arrives in 2027: the inherited pension counts in their estate when they die, so the same money can be taxed at 40% at your death, 40% at your child's and 40% at your grandchild's. It is also theirs, which means it is exposed to their divorce and their creditors.

What is the Pension Legacy Trust?

A discretionary trust, set up now with £10 in it, named on your nomination form to receive the lump sum from your pension when you die. Money paid into it, after any Inheritance Tax, is outside your children's estates for as long as it stays there, and the trust can run for 125 years. The trustees lend or pay money to your children and grandchildren as they need it. Where they lend it, the loan comes back to the trust on the child's death instead of being taxed in the child's estate. The money is protected from a child's divorce, a surviving spouse's remarriage and a grandchild receiving too much too young. We use the Pension Legacy Trust drafted by Solidus, trust specialists who have worked with advisers and estate planners for over thirty years.

It is used by single people, widowed or divorced, who die before 75; by married couples on the second death before 75; and by blended families who would rather pay Inheritance Tax on the first death than hand the pension to a spouse outright. It only works with pensions whose trustees have discretion over death benefits, which covers most modern SIPPs and workplace master trusts, and we check before anything is set up. Once money is in it, the trust runs like any other: a separate taxpayer with a ten-year charge, an annual meeting and records to keep, which our Trust Investment explainer covers.

An example.

A couple's pensions are worth £1 million on the second death, before 75, and the nil-rate bands have already been used against the house. Inheritance Tax of £400,000 leaves £600,000. Paid straight to two children, it sits in their estates and is taxed again when they die, leaving the grandchildren about £360,000. Paid into a Pension Legacy Trust, the £600,000 stays outside the children's estates. They borrow from it as they need to, and the grandchildren inherit what is left in the trust, which has had forty years to grow.

We're married. What's the plan?

On the first death the pension passes to the survivor, exempt from Inheritance Tax. The survivor moves it into their own pension, keeps drawing and keeps gifting. On the second death, the lump sum goes to the Pension Legacy Trust if the survivor is under 75, or to the children directly if over. Both of you set up a trust and both nomination forms are written this way, because

nobody knows who will go first. The survivor will be holding two pensions and the house, so the £2 million line and the 60% Inheritance Tax band need watching from the first death onwards, and the gifting plan usually has to speed up.

If you'd rather your pension didn't go to your spouse outright, because this is a second marriage and you have children from the first, the pension can go to the trust on the first death instead. Inheritance Tax is paid then, after your nil-rate band, and the trust supports the survivor with income while keeping the capital for your children. Life insurance can cover the tax. If you aren't married and you have children together, the spouse exemption and most of the options in this explainer are only available to married couples and civil partners. Whether that is a reason to marry is a question for the two of you, and it belongs in the conversation.

Does my pension push me into the 60% Inheritance Tax trap?

From April 2027, yes, if the numbers add up that way. The residence allowance is withdrawn at £1 for every £2 the estate is worth over £2 million, and the pension now counts. A £900,000 house, £500,000 of savings and £700,000 of pensions is a £2.1 million estate, inside the band. Much of the planning in this explainer, the drawing, the gifting and the trust, is about getting the second estate back under £2 million.



GIVING IT AWAY WHILE YOU'RE ALIVE

What are gifts from surplus income?

An exemption with no seven-year wait and no upper limit. Gifts that are regular, made out of your income, and leave you enough to live as you normally do are outside your estate the day you make them. Regular drawdown payments that you have paid income tax on are generally treated as income for this purpose; the tax-free lump sum is capital and is not. The gifts need a pattern, so a standing order or a yearly payment with a letter saying you intend to continue, and they need records: HMRC's form asks your executors for your income and expenditure for each year, and we keep that schedule for our clients as we go. School fees for grandchildren, a child's mortgage overpayments, pension contributions for a child or grandchild, and the

premiums on a life policy all qualify if they are paid from income you don't need. Combined with drawing up to the £100,000 ceiling, this is the main tool for most of our clients: draw, pay the income tax, give the surplus away, and the pension shrinks at 40% income tax rather than the 78% it can reach on death inside the Inheritance Tax trap.

Where does life insurance come in?

A whole-of-life policy, written in trust, pays out when the second of you dies and covers the Inheritance Tax bill, so the house and the pension don't have to be sold in a hurry to pay it. The premiums can be paid from the pension income you draw, and as regular payments from surplus income they are outside your estate too. The bill itself is unchanged; the policy provides the money to pay it on the day. It suits people who can be insured at a sensible price, who have the surplus income to pay for it, and who would rather have certainty than rely on the gifting outrunning the growth. The premium depends on your ages and health, and whether it is guaranteed for life or reviewable, so we get quotes before anything else. For the right couple the pension ends up paying for the policy that pays the tax on the pension.

WORKING WITH US

What does advice involve?

All of the above, in order. First what you have: every scheme, its rules, its charges and its nomination form. Then what you need to live on, modelled to age 100 with a couple of bad years built in. Then the drawing plan to the right income ceiling, the gifting schedule with the records your executors will need, the nominations rewritten alongside the wills, and the trust set up and waiting. All of it goes in writing before anything moves. After that, every year, because the rules will move again.

Who are you?

Two firms under one roof. Deep Dive Financial Planning gives independent, regulated advice on pensions and investments. Deep Dive Estate Planning drafts the wills, trusts and powers of attorney. Our founder is a Chartered Financial Planner and a Fellow of the Personal Finance Society, holds STEP's Advanced Certificates in Will Preparation and in Trusts and Estates Taxation, and is accredited by the Society of Later Life Advisers. Most of our clients are married couples over 60, and what happens to the pensions on the second death is a question we work on every week.

WHAT TO DO NEXT

Email **info@deep-dive.co.uk** and tell us how we can help, or book a free 20-minute call at trustsadvice.co.uk/mattbriefingddfp.

Further reading

If you're married and your joint estate is between £2 million and £4 million, you can cut the impact of the 60% Inheritance Tax trap with a change to your wills. Book a call with one of our team at trustsadvice.co.uk/mattbriefingddfp and we'll show you the secret sauce.

For the full picture, our one-hour technical webinar takes sophisticated trust planning and breaks it down step by step: deep-dive-trusts.co.uk/resources/videos/technical-inheritance-tax-and-trusts



IN SUMMARY

Seven mistakes to avoid

1. Leaving the pension untouched because that was the advice for thirty years, without re-running the sums. Die after 75 and leave it to a child paying higher-rate tax, and from April 2027 the family keeps 36p of every pound in it.
2. Taking all the tax-free cash because you can, parking it in a savings account, paying tax on the interest and then 40% on the way out of the estate.
3. Drawing past £100,000 of income in a year and paying 60% on the slice up to £125,140.
4. Consolidating the wrong pension: a defined benefit scheme, a guaranteed annuity rate, tax-free cash protected above 25%, or a with-profits fund with an exit penalty.
5. Not having looked at the nomination form since the day you joined the scheme. It is where most of the planning in this guide is done.
6. Letting the pension carry the estate over £2 million, so the residence allowance is withdrawn and every extra pound left costs 60p.
7. Making gifts with no pattern and no records, so the executors can't show HMRC they came from surplus income.

Nine tactics to consider

1. Draw up to £100,000 of income, spend what you spend, and give the surplus away as regular gifts from income. Outside the estate the day you make them, no seven-year wait, no upper limit.
2. Take the tax-free cash with a plan: spend it on something you were buying anyway, give it away and start the clock, or take it in slices to stay under a threshold. It is still available after 75.
3. Use an annuity for the bills. £100,000 buys a healthy 65-year-old about £8,200 a year for life, more in poor health, and the capital stops being an Inheritance Tax problem.
4. One pension on one platform: one nomination, one tax code, one set of statements and one phone call for whoever has to pick it up.
5. Name a Pension Legacy Trust, set up now with £10 in it, on the nomination form to catch the lump sum on death before 75. It lends to the children rather than giving, and the loan comes back to the trust when they die.
6. Under 75, the lump sum goes to the trust. Over 75, to a person. Both of you set up a trust and both nomination forms are written both ways, because nobody knows who goes first.
7. In a second marriage, send the pension to the trust on the first death, pay the Inheritance Tax then, and let life insurance cover it.
8. A whole-of-life policy in trust, with the premiums paid from drawn pension income as gifts from income: the pension pays for the policy that pays the tax on the pension.
9. Have the scheme pay the Inheritance Tax straight to HMRC out of the pension, so the children aren't finding the money elsewhere.

Email **info@deep-dive.co.uk** and tell us how we can help, or book a free 20-minute call at **trustsadvice.co.uk/mattbriefingddfp**.

READY TO TAKE THE PLUNGE?

The support you need is only a few short steps away. Give us a call or an email, or visit our website, to get started.

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This explainer is for general information only and is not personal advice. Figures assume rules in force at October 2026, including the Finance Act 2026 provisions taking effect on 6 April 2027. Annuity rates are illustrative and change frequently.

The value of investments, and the income from them, can fall as well as rise, and you may get back less than you invest. Tax treatment depends on individual circumstances and may change in the future.

A pension is a long-term investment the fund value may fluctuate and can go down. Your eventual income may depend upon the size of the fund at retirement, future interest rates and tax legislation.

The Financial Conduct Authority does not regulate Inheritance Tax Planning, trusts or will writing.

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