

For many savers, pension contributions have long been a tax-efficient and routine part of financial planning, often facilitated through payroll and employer schemes. Salary sacrifice has played a key role, allowing individuals to exchange salary for contributions while avoiding income tax and National Insurance (NI) on the amount sacrificed via the scheme.

That landscape is set to change. From April 2029, salary sacrifice will be capped, with NI applied to pension contributions above £2,000 a year. Alongside this, reforms to the inheritance tax (IHT) treatment of pensions are adding further complexity to retirement planning. The government confirmed in 2024 that most unused pension funds and death benefits will fall within the scope of IHT from April 2027.

Together, these changes mark a broader shift in how pension wealth is treated both during accumulation and on death.

Salary sacrifice

The Saving and Investment Alliance head of policy products and long-term savings, Renny Biggins, says salary sacrifice will “target those who are on higher salaries and those who choose to pay in contributions in excess of the minimum”.

The problem, Biggins says, is that minimum pension contributions “won’t translate into adequate retirement pots at retirement”, so employees or their employers will likely need to contribute more. However, under the new rules, anyone contributing over the threshold will see a reduction in their take-home pay.

“Despite the tax benefits that still make saving into a pension attractive, this drop may be enough for some employees to reconsider current or future contribution levels,” he explains.

AJ Bell head of public policy, Rachel Vahey, emphasises the potential implications of this change for savers.



Summary

- In the 2024 Autumn Budget, Chancellor, Rachel Reeves, announced that most unused pension funds and death benefits will be brought into the scope of inheritance tax (IHT) from 6 April 2027.
- In the 2025 Autumn Budget, Reeves also confirmed that, from April 2029, salary sacrifice will be capped, with National Insurance applied to pension contributions above £2,000 a year.
- While targeting different stages of the pension journey, both changes have prompted significant industry debate over whether they risk adding complexity and discouraging long-term pension saving.

Taxing confidence

With upcoming tax changes set to reshape both pension contributions and inheritance, Paige Perrin examines how reforms to salary sacrifice and inheritance tax (IHT) could affect saving behaviour, potentially weakening incentives at a critical time for pension adequacy

Instead of helping the nation save for their financial futures, she suggests that many may feel that pension tax advantages are “politically up for grabs”. She cautions that this could “cast a shadow over the incentive to save”, potentially discouraging some individuals from saving adequately for

their retirement and leaving them worse off later in life.

Employer behaviour is another element to consider with this policy change, as industry experts suggest that employers are likely to reduce their use of salary sacrifice as a result.

LCP partner and head of pensions



tax, Alasdair Mayes, expects that “the cap will kill off most salary sacrifice for bonuses”, which he justifies by highlighting figures from the Office for Budget Responsibility that show nearly half of salary sacrifice arrangements are allocated to bonuses.

Adding to this, People’s Partnership head of business development, Max Gist, says the biggest change is likely to be in how employers structure their overall benefits offering over time.

“For organisations that have used salary sacrifice as a core part of their reward strategy, there will be a need to review contribution structures, payroll processes, and the balance of benefits as the policy evolves,” he states.

This could create a problem for the pension industry as there is less “tax-optimised engagement” at the workplace level and weaker automatic saving incentives.

Meanwhile, Scottish Widows pensions expert, Susan Hope, proposes that confusion risk is another problem

that could arise from the changes to salary sacrifice. She warns that a lack of clear communication well in advance of the change could “undermine good outcomes for savers”.

“Where employees hear ‘salary exchange is restricted’ with no context, you could have people opting out, thinking it’s not worth it. Auto-enrolment (AE) has been so successful as a mechanism due to its reliance on inertia. The proposed change and associated headlines are creating unnecessary friction, which could lead to poor, unintended consequences,” she says.

IHT

IHT is another area that could create significant challenges for pension saving.

Concerns about this policy are already evident, with the government being told it needs to make “major changes” to its policy proposals to ensure they are implemented fairly and effectively, following the launch of an inquiry into bringing pensions into the

scope of IHT by the House of Lords.

Despite this scrutiny, the government pressed ahead with the policy change and made a small number of amendments since the policy’s introduction. These include allowing personal representatives, responsible for calculating and paying any IHT due, to withhold up to 50 per cent of pension benefits for up to 15 months, providing additional flexibility.

Mayes notes that the decision to exclude death in service benefits, as well as transfers to a spouse or civil partner, means the overall impact of bringing pensions into the scope of IHT may be “not as great as first feared”.

Gist adds that, while the changes will affect only a relatively small number of high-net-worth individuals, they introduce additional complexity into retirement planning.

“For most savers, pensions will remain a core long-term savings vehicle for providing an income throughout retirement, while for those with more complex needs, there will be an increasing focus on how different assets interact and the role of financial advice in planning,” Gist says.

Supporting this view, Quilter retirement specialist, Adam Cole, explains the change could prompt “those who are well informed or supported by financial advisers are likely to revisit existing strategies and move away from drawing pensions last, instead accessing pension assets earlier in retirement”.

And Isio head of wealth planning, Mark Campbell, notes that the consultancy is already “seeing more clients thinking about passing on wealth sooner to the next generation”. This behaviour change, he says, has also come alongside a broader shift towards balancing pension saving with other investment wrappers such as offshore bonds and discounted gift trusts.

However, Cole warns that for less well-informed individuals, loved ones may only discover after death that pension benefits they expected or need

are reduced by IHT. He suggests that these “negative experiences that follow are likely to influence behaviour more widely over time”.

Building on this concern about behavioural knock-on effects, Biggins adds that people may begin to question whether increasing pension contributions is worthwhile if a significant portion could be subject to IHT.

He also cautions that if the IHT threshold remains unchanged while AE contributions rise, younger savers on median incomes could eventually build pension pots that exceed the threshold.

Combined with other savings and assets, IHT risks becoming a mainstream tax rather than one aimed at the ultra-wealthy, he argues.

Vahey raises a serious industry concern, that although “the bare bones” of how this change will work in practice have been provided to the industry, “worryingly, we still don’t have the complete picture”.

With less than a year until implementation, she warns that the industry is still “waiting for the government to fill in some of the blanks on process and detail”.

In particular, Biggins highlights that the industry is also still awaiting further draft regulation on how information will be shared between pension scheme administrators and personal representatives in relation to bringing pensions into the IHT framework.

“IHT and pensions by their very nature are entirely incompatible, and there will be delays in beneficiaries receiving their money, retrospective reclaims and refunds required and mistakes made,” he says.

Mayes is also concerned about the time constraints, saying: “Pension providers will struggle to get everything in place in time for the IHT changes coming into force in 2027. Providers will have to do what they can and update what they are doing as more details emerge”.

Meanwhile, on the operations side, Scottish Widows pensions specialist, Gareth Davies, believes both providers and advisers will have to “fundamentally change” their current processes and procedures to accommodate the complexities of accounting for potential IHT liabilities.

Campbell highlights the lack of financial literacy and the increasing number of jobs held over a lifetime due to frequent job switching as material complications for personal representatives.

“The natural reaction to something being more complex and less tax-efficient is to save less into it”

Another issue with the IHT changes, according to Campbell, is the enhanced risk that the personal representative or executor will be unfamiliar with the process. This could result in increased susceptibility to fraud and a greater risk of misvaluation and miscalculation.

Future impact

Across both policy changes, a clear theme of uncertainty emerges, which could severely impact pension saving behaviours.

This concern comes at a particularly sensitive time. Pensions adequacy is already in the spotlight, with the revived Pensions Commission examining the long-term adequacy, fairness and sustainability of the UK system. Against this backdrop, further complexity may prove counterproductive.

Biggins argues that the “unprecedented and relentless volume of regulatory change” that the industry is currently experiencing is part of the problem.

“Pensions are highly politicised and as such, are subject to constant

consultations and changes, which only serve to confuse consumers and create disengagement,” he adds.

This concern around growing complexity is echoed by Mayes, who warns that layering additional tax considerations, such as changes to IHT and salary sacrifice, onto an already ‘complex’ system could discourage saving altogether.

“The natural reaction to something being more complex and less tax-efficient is to save less into it. I fear the long-term impact will be to reduce adequacy at a time when we know savings need to be improved. With more people renting into retirement and the numbers projected to increase further, people need higher pensions,” Mayes adds.

Some in the industry believe a more fundamental shift in policymaking is needed.

Indeed, Barnett Waddingham self-invested pensions technical specialist, James Jones-Tinsley, highlights the importance of taking pensions out of short-term political cycles, calling for a more stable, cross-party approach that avoids reactive or ‘knee-jerk’ reforms.

Without this, there is arguably a risk that constant change undermines long-term planning and security.

But there is scepticism about whether such stability can realistically be achieved. Biggins notes that by the time the longer-term effects of current policies are fully understood, the UK could be in a new parliamentary cycle, potentially facing an “influx of regulatory changes”.

In that context, he stresses that cross-party consensus remains essential, even if, in practice, achieving this “seems to be the impossible dream”.

And without breaking this cycle, the risk is that these tax changes don’t just affect adequacy but start to erode confidence in pensions to the point where people question whether they are still worth saving into at all.

 **Written by Paige Perrin**