Reeves' inheritance tax raid puts millions at risk of poverty in later life, warns ROS ALTMANN

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The bombshell Budget inheritance tax announcement is a potential disaster for pensions.

It will mean less money going in, more early withdrawals, lower pension fund investment in long-term higher-return assets and more pensioners reliant on state benefits.

This is horribly reminiscent of Gordon Brown's 1997 dividend tax credit removal from UK pension funds which, as with this Budget, saw little industry opposition at the time.

It took several years to recognise this fatal blow for traditional final-salary-type defined benefit (DB) pensions.

Scrapping inheritance tax (IHT) exemption for unspent pensions could be equally damaging to defined contribution (DC) schemes that replaced once-thriving private sector DB arrangements, undoing the brilliant incentives of George Osborne's 2015 freedoms.

Tax grab: Chancellor Rachel Reeves said in the Budget that from April 2027, pensions would no longer be exempt from inheritance tax

These removed requirements for DC pensions to buy annuities (where insurers can pocket pension funds of those dying, leaving nothing for heirs) or buy expensive drawdown funds with a 55 per cent death tax.

After 2015, people could take control of their pensions, feeling safe contributing more to invest long-term, and only withdrawing money when they chose.

The tax system encouraged people to spend any other savings first, keeping pension funds for their 80s and 90s – the original purpose.

Removing IHT-exemption takes us back to the bad old days. There may be little sympathy for millionaires, but it is those near the middle who are worst-affected.

Most people underestimate their life expectancy, worry about dying relatively young, don't want annuities and would rather not lose most of their pension investments to the taxman.

This is not just 40 per cent tax on unused funds. It is far worse.

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If the Chancellor's proposals proceed in 2027 as planned (and I hope they don't, so please reply to the consultation) those inheriting pensions from anyone dying over age 75 face income tax on withdrawals.

So HMRC takes 52 per cent, 64 per cent or 67 per cent of an inherited fund, depending on tax brackets. This is more like confiscation than taxation.

Consider someone with a £500,000 pension fund (which could buy about £20,000 annual index-linked pension annuity income).

After taking tax-free cash, the remaining £375,000 could be withdrawn at 20 per cent tax, by keeping annual income below £50,271, which is the 40 per cent threshold.

If they have a full £12,000 state pension, that leaves around £38,000 a year available at basic rate tax. The fund could be gone within ten years.

A £400,000 fund could go in under eight years. People on average incomes starting withdrawals at 55 would empty funds much sooner.

Anyone already over state pension age may now consider withdrawing as much as possible straight away, to avoid the massive tax loss on death.

Commentators have not yet recognised how damaging this IHT change is. The Government plans further pension reviews, creating yet more uncertainty for long-term planning, again damaging pension confidence.

Millions are at risk of later-life poverty. The UK economy and markets will suffer as less is invested for the long-term. It's time to wake up.

Don't destroy DC pensions, harness them to boost growth instead.

How much is inheritance tax and who pays?

Inheritance tax is levied at 40 per cent on estates above a certain size.

You need to be worth £325,000 if you are single, or £650,000 jointly if you are married or in a civil partnership, for your loved ones to have to stump up inheritance tax.

A further allowance, the residence nil rate band, increases the threshold by £175,000 each - so £350,000 for a married couple - for those who leave their home to direct descendants. This creates a potential maximum joint inheritance tax-free total of £1million.

This own home allowance starts being removed once an estate reaches £2million, at a rate of £1 for every £2 above the threshold. It vanishes completely by £2.3million.

Chancellor Rachel Reeves said in the Budget these thresholds will be frozen until 2030.