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# A guide to Inheritance Tax

Passing on wealth to  
the next generation



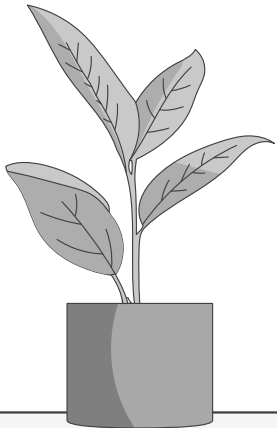


# Introduction

**When a loved one dies, their estate might be subject to Inheritance Tax (IHT). Whether this tax applies depends on the estate's value and whether it surpasses the IHT threshold.**

It is a good idea to talk about IHT and estate planning well before it is urgently needed. This way, you and your family can make informed decisions, manage your assets wisely, and hopefully avoid disputes after your death.

This guide covers everything you need to know about IHT, including what it is, how it works, and how to reduce your tax liability.



# What is IHT?

**IHT is levied on the estate of a person who has passed away. It applies only to estates valued above £325,000. For tax purposes, the estate includes the deceased person's money, possessions, and property, as well as any gifts given in the seven years prior to death.**

## Who is required to pay IHT?

In the UK, as mentioned above, IHT is only due on estates valued at £325,000 or more. This means that the first £325,000 of your estate is tax-free.

The responsibility for valuing the estate and paying the IHT falls to the person managing the estate. If there is a Will, this duty lies with the executor who must ensure that the IHT bill is settled on behalf of the deceased.

If there is no Will, the responsibility of handling the estate and paying any IHT falls to an administrator. This person is usually appointed by the court and follows the rules of intestacy to manage and distribute the estate.

The administrator must value the estate, ensure all debts and taxes are paid, including IHT, and then distribute the remaining assets according to the law.

## How much is IHT?

IHT is charged at 40 per cent on the value of the estate that exceeds the £325,000 threshold. Let's take a look at an example:

Estate value	= £800,000
IHT threshold	= £325,000
Taxable amount	= £475,000
Tax owed at 40 per cent	= £190,000
Remaining estate value	= £610,000

# When do you have to pay IHT?

**IHT must be settled by the end of the sixth month following the person's death. If it is not paid by then, HM Revenue & Customs (HMRC) will start charging interest on the outstanding amount.**

Executors have the option to pay the tax on certain assets, like property, in instalments over 10 years, but interest will still accrue on any unpaid tax.

Should the asset be sold before the full IHT is settled, the executors must ensure that all outstanding instalments and interest are paid at that time.

To manage this effectively, the executor should make a partial payment on the account within the six months, even if the full valuation of the estate isn't complete. This advance payment helps reduce potential interest charges if there are delays in selling assets to cover debts and taxes.

If the executor or administrator pays the tax themselves, they will be able to reclaim the amount from the estate, and HMRC will refund any overpaid IHT once probate is granted.

As an executor or administrator, you must submit a detailed account of the estate within one year of the death to avoid penalties.



# Exemptions to IHT

**There are a few ways to reduce your potential tax liability, including annual exemptions, marriage gifts, donating to charities and gifts from income.**

## Annual exemptions

Each year, you can give away up to £3,000 worth of gifts without incurring any IHT. This is known as the annual exemption. If you don't use the full £3,000 in one year, you can carry over any unused portion to the next year, but only for one year. This can help reduce the value of your estate over time.

## Leaving your estate to your spouse

In the UK, any assets you leave to your spouse or civil partner are generally exempt from IHT. This means you can pass on your estate to your spouse without incurring any IHT charges, regardless of the value.

If you leave your estate to your spouse, any unused portion of your personal IHT allowance (£325,000) can be transferred to them.

This means that when your spouse passes away, their estate can benefit from the combined allowance of both partners, potentially doubling the amount that can be passed on without IHT.

Additionally, if you leave your main home to your direct descendants (children/grandchildren), you may benefit from the Residence Nil-Rate Band (RNRB), increasing your tax-free allowance.

The RNRB for the 2024/25 tax year is £175,000. When combined with the spousal exemption, this can significantly reduce the amount of IHT payable.

By leaving your estate to your spouse, you not only avoid IHT at the time of your death but also provide them with a potentially larger estate that can benefit from the unused IHT allowance when they pass away.

## Gifts

You can give gifts worth up to £250 per person per year, free from IHT. However, this exemption cannot be used in conjunction with the annual exemption for the same recipient. On the occasion of a marriage or civil partnership, the below gifts are exempt from IHT:

- Up to £5,000 to your child.
- Up to £2,500 to a grandchild or great-grandchild.
- Up to £1,000 to anyone else.

You can make regular gifts from your surplus income without incurring IHT, as long as they do not affect your standard of living. These are known as 'gifts out of surplus income' and can be a useful way to reduce the value of your estate while maintaining your financial well-being.

You can reduce the IHT rate to 36 per cent if you gift at least 10 per cent of your estate to charity in your Will. Leaving a portion of your estate to charity can potentially result in more money being left to your other beneficiaries, but it does not guarantee it in every situation.

## Potentially Exempt Transfers (PET)

A PET is a gift made during your lifetime that is not immediately subject to IHT, provided you survive for seven years after making the gift.

However, if you die within seven years of making a PET, the gift may still be subject to IHT. The tax due will depend on how many years have passed since the gift was made.

The tax is calculated on a sliding scale known as 'taper relief,' which reduces the amount of tax payable based on how many years you survived after making the gift:

- **0-3 years:** Full 40 per cent tax rate.
- **3-4 years:** 32 per cent tax rate.
- **4-5 years:** 24 per cent tax rate.
- **5-6 years:** 16 per cent tax rate.
- **6-7 years:** 8 per cent tax rate.

If you make several PETs and die within seven years, the value of all such gifts may be added together to determine the total IHT liability.

# Trusts

**Making outright gifts often means relinquishing control over the assets you give away. If you want to retain a say in how your wealth is used and who benefits, then trusts offer a flexible solution.**

By placing your assets into a trust, you can dictate who receives the money, when they receive it, and for what purpose. While trusts can introduce an additional layer of complexity, they are a powerful tool for managing your IHT and ensuring your loved ones keep more of what you have worked hard to provide.

When you transfer money or property into a trust, and as long as certain conditions are met, you technically no longer own those assets.

This means they might not count towards your IHT bill when you pass away, potentially reducing the tax burden on your estate.

There are a variety of trust options that are available with some being more complex and costly than others.

Some trusts come with their own set of IHT rules. Once assets are transferred into these trusts, they are typically shielded from IHT when you pass away.

However, other trusts might face higher rates of Income and Capital Gains Tax (CGT). It is important to know the specifics of your trust to ensure you are managing all potential tax impacts properly.

## Some examples of trusts you can utilise are:



**Bare trusts** - The beneficiaries have an immediate and absolute right to the assets in the trust. While this type of trust does not provide significant IHT benefits, it can simplify the transfer of assets to beneficiaries when they reach a certain age.

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**Discretionary trusts** - The trustees have the discretion to decide which beneficiaries receive income or capital and how much they receive. This flexibility can help manage IHT as the assets do not form part of the beneficiaries' estates for IHT purposes until distributed.

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**Interest-in-possession trusts** - Beneficiaries have a right to the income generated by the trust assets but not the capital. The trust's capital will eventually be passed to other beneficiaries. This can be useful for controlling the timing of when assets are passed on.

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**Accumulation and maintenance trusts** - These are designed for minors. The trustees manage the trust until the beneficiaries reach a specified age. They allow the assets to grow, potentially reducing the overall IHT burden.

For more information on trusts, please speak to one of our specialist advisors who can assist you in setting up and managing trusts – no matter the complexity.



# Can life insurance be used to pay IHT?

**You can take out a life insurance policy with the specific purpose of covering the potential IHT bill on your estate.**

When you die, the policy pays out a lump sum, which can be used to cover the IHT, ensuring that your beneficiaries do not have to dip into the estate to cover the tax.

To ensure that the insurance payout is used solely for IHT purposes and not subject to IHT itself, it is often a good idea to write the policy in trust.

This means the insurance money goes directly to the trust, and not your estate, so it avoids being taxed as part of your estate.



# Common pitfalls and advice

## IHT can be very complex, leaving many people vulnerable to pitfalls.

- ! **Pitfall** - Many people leave IHT planning until it is too late, resulting in unexpected tax liabilities or limited options for reducing IHT.
  - ✓ **Advice** - Start planning as early as possible. Regularly review your estate and consider various strategies for reducing IHT, such as gifts, setting up trusts, or taking out life insurance policies. Engage with our team who can provide tailored advice and help you develop a proactive plan.
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- ! **Pitfall** - Gifts made during your lifetime may still be subject to IHT if you die within seven years, so, failing to plan gifts carefully can lead to unexpected tax charges.
  - ✓ **Advice** - Use exemptions and allowances to make tax-efficient gifts, such as the annual exemption, small gifts exemption, and gifts for weddings. You should make sure to document gifts properly and be aware of the seven-year rule for Potentially Exempt Transfers (PETs).
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- ! **Pitfall** - Trusts can be useful in managing IHT, but they come with their own rules and tax implications. Mismanagement can lead to tax charges or administrative issues.
  - ✓ **Advice** - Understand the different types of trusts and their tax implications. Speak with us to ensure trusts are properly established and review them regularly to accommodate any changes in your circumstances or tax regulations.



# Hypothetical scenario

**This example demonstrates how various tools, such as annual gift allowances, charitable donations, PETs, and trusts, can help lower the taxable value of an estate and reduce the IHT burden.**

**Scenario:** Married couple with an estimated value of £800,000 (both eligible for £325,000 Nil Band Rate)

## Basic calculation without planning

- Nil Rate Band per spouse = £325,000 (combined this is be £650,000).

As the value of the estate is above the combined allowance, £150,000 would be subject to IHT at the 40 per cent rate. This would result in a £60,000 IHT charge (final value of the estate would be £740,000).

## Example of IHT planning

### Gifts using annual exemption:

- Annual exemption = £3,000 per person per year. For a couple, this is £6,000 annually.
- Over 5 years, this totals: £6,000 x 5 = £30,000.
- Estate Value after Annual Gifts: £800,000 - £30,000 = £770,000.

### Charitable donations (if the couple decides to leave 10 per cent of their estate to charity):

- 10 per cent of £800,000 = £80,000.
- Adjusted Estate Value: £800,000 - £80,000 = £720,000.

### Potentially Exempt Transfers (PETs):

If the couple makes gifts of £100,000 as PETs. These gifts are exempt from IHT if they survive seven years.

- Value of PETs = £100,000
- Estate Value after PETs (if within 7 years):  $£800,000 - £100,000 = £700,000$

### Trusts:

If the couple places £200,000 into a discretionary trust, this amount is removed from their estate.

- Trust Amount = £200,000.
- Estate Value after Trust Contribution:  $£800,000 - £200,000 = £600,000$ .

### Final estate value calculation with all planning strategies

- Initial estate value = £800,000.
- Less annual exemption gifts: -£30,000.
- Less charitable donation: -£80,000.
- Less PETs (if made more than seven years before death): -£100,000.
- Less trust contribution: -£200,000.
- Adjusted Estate Value:  $£800,000 - £30,000 - £80,000 - £100,000 - £200,000 = £390,000$ .

### IHT liability calculation

- Adjusted estate value: £390,000

Since the adjusted estate value of £390,000 is below the combined allowances of £650,000, no IHT would be due in this scenario.

# Upcoming changes to IHT

The October 2024 Budget introduced significant changes to IHT, bringing more individuals into the crosshairs of HMRC.

## Non-UK assets

From 6 April 2025, the UK moved from a domicile-based IHT system to a residence-based system.

This change brings non-UK property into the scope of IHT for individuals and trusts, depending on residency status.

- **Long-term residents** – An individual will be considered long-term resident and liable for IHT on non-UK assets if they have lived in the UK for at least 10 out of the last 20 tax years.
- After leaving the UK, individuals will remain within the IHT scope for three to 10 years, subject to transitional rules.
- **Trusts** – Any non-UK assets placed into a settlement by a long-term resident will now be subject to IHT charges.

## Trusts

The IHT treatment of trusts changed significantly in April 2025. The treatment of trust assets will depend on the settlor's long-term residence status at the time of an IHT charge. If the settlor has been resident in the UK for 10+ years, all UK or foreign trust assets, will be subject to IHT.

Trusts will face periodic charges of up to six per cent every 10 years, regardless of the location of the assets.

Trusts created by a non-domiciled settlor before 30 October 2024 will retain exclusions for non-UK assets held before this date.

These assets will not be included in the settlor's estate for IHT on death, even if the settlor later becomes a long-term resident.

This exclusion does not apply to periodic charges, which will still be assessed based on the settlor's residency status.

The IHT status can change depending on the settlor's residency status.

If a settlor is a UK resident for 20 years as of April 2025, all trust assets are liable for IHT. However, if the settlor moves abroad and remains non-resident for 10 years, foreign assets revert to being excluded. This may trigger an exit charge on foreign assets leaving the scope of IHT.

### **What is changing to Business and Agricultural Property Reliefs?**

The October 2024 Budget introduced significant changes to Agricultural Property Relief (APR) and Business Property Relief (BPR) under Inheritance Tax (IHT), effective from April 2026.

The 100 per cent relief on agricultural and business assets will be capped at £1 million per individual, with values above this threshold eligible for only 50 per cent relief.

With the existing nil-rate bands, this may mean that a farming couple can only protect the first £3 million of assets for beneficiaries.

This cap could significantly affect large farming operations and high-value businesses.

### **What is changing to pensions?**

Currently, defined contribution pensions do not form part of an individual's estate and are not subject to IHT.

From 6 April 2027, defined contribution pensions may be subject to IHT, depending on the value of the estate and who inherits the pension. Where applicable, the tax rate could be up to 40 per cent.

While many people may not have significant sums left in their pensions at the time of death, this will affect an estimated 10,500 estates for the first time and increase IHT liability for 38,500 estates.

If you own a home, your total estate value, including your pension, could exceed tax-free allowances, resulting in an unexpected IHT bill.

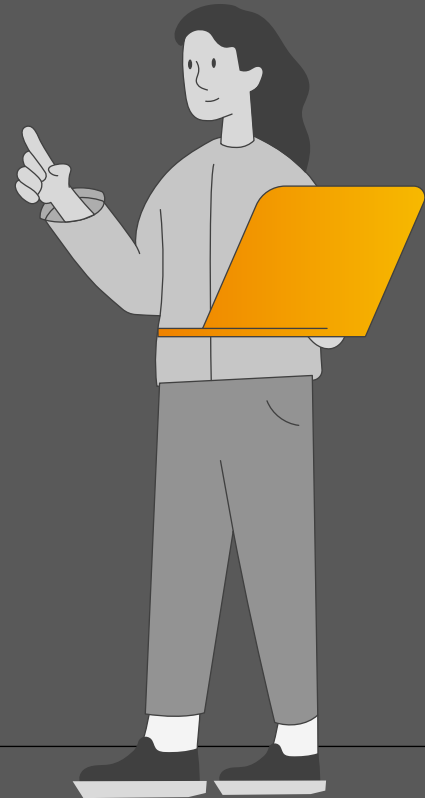
# Seek professional advice

When it comes to managing IHT, we understand it can feel overwhelming. We're here to help you manage this complex process with ease and clarity.

Our experienced team can provide you with:

- A personalised plan to minimise your IHT.
- Advice on preparing for the upcoming changes to IHT.
- An accurate value of all your assets.
- Guidance on effective gifting strategies.
- Assistance setting up and managing a trust.
- Advice on incorporating charitable donations into your estate plan.

**Don't let IHT concerns add to your stress. Contact us today, and let's start working on a plan that suits your needs and secures your legacy.**





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