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INHERITANCE TAX

Inheritance Tax (IHT) is a popular subject with callers to our tax line. Whether you are looking to protect your assets to benefit future generations, help your children get on the property ladder or help loved ones pay off debts, it is understandable that you may wish to minimise any tax payable. This factsheet sets out the nature of IHT and when it is due.

The basics - What is IHT?

IHT is a tax payable on an estate after someone dies where its taxable value exceeds a permitted allowance (currently £325,000) per individual. From 2017/18 an additional tax free allowance, known as a residence nil rate band (RNRB) is available where a family home is passed on death to direct descendants. This allowance started at £100,000 and increased to its current rate of £175,000 by 2020/21. Entitlement to this allowance is excluded in respect of certain high value estates. Where an estate does not qualify for the full amount of RNRB, the estate may be entitled to an additional amount of RNRB known as a downsizing addition providing certain conditions are satisfied. Further information with regard to the RNRB and downsizing relief can be found here. In addition to assets held at the date of death in a personal capacity, it can also include assets held in certain trusts and gifts made in the seven years preceding death.

From April 2027, it is intended that IHT will also apply to unused pension pots. IHT may also be payable during your lifetime in relation to some transfers and gifts. This typically applies to transfers and gifts into certain trusts (see section below on the seven-year rule and its exceptions). Special rules may apply to non uk domiciled individuals/non longterm UK residents.

What is a gift?

A gift can be:

- Anything that has a value e.g. money, possessions, property.
- The sale of an item at an undervalue e.g. the sale of a property for less than its true value. The difference is treated as a gift.

What gifts are exempt from IHT?

- Transfers between spouses and/or civil partners living permanently in the UK.
- Lifetime gifts up to £3,000 per annum given away by the deceased. This is the annual exemption and any leftover exemption in one tax year may be carried forward to the following year only. This will mean the available exemption will be increased to £6,000 (based on current rates) if no gifts were made in the previous tax year.
- Gifts up to £250 to any number of individuals but restricted to one per individual each tax year. If making use of this exemption any other gifts made to that individual during that year cannot be offset against the £3,000 allowance
- Regular gifts made out of the donor’s income (after tax), provided that in making such gifts their normal lifestyle is not affected. This would cover such things as birthday gifts, life assurance premiums and payments into a saving account.
- Gifts in consideration of marriage of up to £5,000 to a child, £2,500 to a grandchild or great grandchild and £1,000 to anyone else.

- Payments to help with living costs, including payments to an ex-husband/wife/civil partner, payments to a relative who is dependent because of old age/infirmity and payments to a child (including adopted and stepchild) under 18 years old or in full-time education.
- Gifts to charities, universities, museums and political parties (subject to certain conditions).

In addition, and providing specified conditions are met, the following may be outside the scope of IHT:

- Transfers between spouses and civil partners are exempt without limit both during lifetime and death. From 6th April 2025 where the transferor is a long term UK resident but their spouse or civil partner is not, the exempt amount is restricted to a lifetime total of £325,000. Before 6th April 2025 a similar rule applied to transfers to a non-domiciled spouse or civil partner.
- Values attributable to an unincorporated business, partnership interest or shares in a privately-owned company may benefit from Business Property Relief (BPR).
- Values attributable to farmland and farm buildings could be subject to Agricultural Property Relief (APR).

Further guidance on business relief inheritance tax can be found here and further guidance on agricultural relief on inheritance tax can be found here. From 6th April 2026 it is intended that the amount of BPR and APR is capped.

What is the seven-year rule?

The majority of gifts made during an individual's lifetime will be what is known as Potentially Exempt Transfers or PETs. This means that provided the donor (the person making the gift) survives seven years then these gifts will be ignored when calculating the value of someone's estate. In the event of death within seven years, the gifts will be included in the estate but subject to deductions to reflect the permitted exemptions (see above). Taper relief may also be applied if the donor survives more than three years but less than seven years from the date of the gift. Taper relief provides a percentage reduction in the amount of tax charged for the years survived since the gift was made. It does not, however, reduce the value of the gift to be included in the estate. Exceptions to the rule include:

- Transfers to the majority of trusts which are immediately chargeable to IHT known as chargeable lifetime transfers (CLTs). Here a liability will arise if the value transferred (together with other CLTs made in the previous seven years) exceeds the IHT threshold (currently £325,000).
- Gifts where the donor has retained a benefit – referred to as a Gift With Reservation (GWR). This can most commonly arise, for example, where the family home is transferred to another family member (possibly to avoid IHT and/or nursing home fees) but the donor remains living there. These gifts will remain within the donor's estate unless, for example, the donor was to pay a commercial rent in the case of property transfers. As an alternative to the GWR treatment, there is the possibility of an income tax charge known as the pre-owned assets charge (see here for detailed guidance). This, however, is a complex area so professional advice should be sought.

IHT ordinarily applies to all assets wherever held including overseas. In relation to non UK-domiciled individuals IHT only applied to assets situated in the UK.From 6th April 2025 significant changes were introduced so that the domicile and deemed domicile rules were replaced by new long term resident rules such that assets held overseas may be caught. The rules can be complex and professional advice shoud be sought. For further information see here.

What rate of IHT is payable?

Upon death, IHT is payable at a rate of 40 per cent on the excess over the IHT allowance subject to the following:

- A reduced rate of 36 per cent applies if more than 10 per cent of the estate is left to charity.
- If there has been a lifetime transfer which has been subject to IHT then credit will be given for the tax already paid. For chargeable lifetime transfers over and above the IHT threshold the rate is 20 per cent.
- If there is any tax attributable to lifetime gifts which have failed the seven-year rule but at least three years have elapsed since the date of gift then the amount of tax may be reduced through taper relief.

When is IHT Payable

For lifetime transfers between 6th April and 30th September, IHT is payable by the following 30th April.

Within six months from the end of the month of transfer for other lifetime transfers.

Within six months from end of month of death for transfers on death.

IHT may be payable on a number of occasions in relation to trusts. For further information see here.

Who pays IHT and what if I can't pay?

The executor of a will/administrator of an estate will generally pay any IHT on all but non-trust assets or what is commonly referred to as the free estate. This comprises all property other than that held within a trust (settled property). Trustees will be responsible for IHT attributable to property in a trust.

In some instances, recipients of gifts made during the deceased's lifetime may be liable for IHT. For example, a deceased's will or deed of gift may stipulate that the donee (the person receiving the gift) is responsible for accounting for any IHT that may be due in relation to the gift. These gifts are referred to those as which bear their own tax, in contrast to those gifts where the donor or the estate bears the tax, which are referred to as gifts/ legacies free of tax. If, however, they refuse or cannot pay, HMRC will seek to collect this from the estate. If there is an insufficiency of funds it may be possible to pay the IHT in ten annual instalments. This will depend on the type of property within the estate – see here. It is possible to take out insurance policies designed to cover IHT liabilities but professional independent financial advice should be sought.

What forms do I need to complete?

This will depend on where the deceased lived, the value of the estate and the date of death. For deaths prior to 1st January 2022 - as a general rule, if there is no tax to pay, the form IHT 205 (Form C5 in Scotland) would require completion. In other instances, a Form IHT 400 will be needed. Additional forms may be required where, for example, trusts are involved, it is intended to transfer an unused nil rate band (see below) or if the deceased died living abroad.

Further information and guidance may be found here:

- Valuing the estate of someone who died
- Inheritance tax, return of estate form IHT 205
- Inheritance tax form IHT 400

For deaths on or after 1st January 22 most non taxpaying estates will no longer have to complete an IHT form to obtain probate/confirmation in Scotland. Qualifying "excepted" estates will only be required to provide three IHT values and make two declarations on the probate/confirmation application. Information on checking whether an estate is a "excepted estate" may be found here.

Frequently asked questions from our callers

My parents are thinking of passing on the family home. What are the implications?

This is one of the most frequently asked questions concerning IHT. For varying reasons, callers are keen to explore options for reducing the value of family assets which may be liable to IHT or care funding. Here we try to set out the various implications of transferring the property:

- Passing the home as a gift (to example to the children) will be subject to the seven-year rule and taper relief (see above).
- Passing the property as a gift but continuing to live there rent-free will be treated as a GWR (see above) and will remain within the donor's estate even if they survive seven years.
- If giving away the property and moving out the seven-year rule will apply provided that the original owner only stays there for social visits and short periods of time.
- Giving away part of a home to someone who already lives there or someone who moves in. If bills shared then the normal seven-year rule will apply.
- If property is sold and the proceeds gifted to children then the seven-year rule will apply to the cash gift. If the proceeds are used to purchase a property which the parent(s) subsequently occupies then this could fall foul of either the GWR or pre-owned asset rules.
- Leaving home in a will. The value will be included in estate for IHT purposes, although if left to a spouse or civil partner will not be taxable. (Unless restriction with regards to transfers to non UK domiciled spouse/non long term resident spouse/civil partner applies - see above.)

It is also important to bear in mind that there may be Capital Gains Tax implications for the donor (initially) and the donee (further down the line) if the property concerned represents a second property. It is advisable for further legal advice to be sought.

I've heard we can avoid IHT by setting up a trust – is this right?

Trusts can be a useful instrument with which to protect assets from misuse or squandering by intended beneficiaries where they are deemed to be not old or responsible enough to be given the assets outright. Whilst the use of trusts can help mitigate/ eliminate IHT, a lot will depend on the individual circumstances and the type of trust in question.

Whether IHT charges arise will depend upon a number of factors including increases in value of trust assets during the lifetime of the trust, the type of trust involved, how long the settlor survives from setting up trust and the value of assets being placed into trust. In this last instance, it may be necessary to consider the value of any transfers made into certain other trusts in the previous seven years. The area of trusts is a complex one and there are other taxes apart from IHT to consider, so professional advice should be sought. For an overview of trusts and their respective tax treatment see the link here.

I have heard about transferring the nil rate band –how does this work?

It is very common that spouses/civil partners leave all their estate to the other. Subject to the restriction re non-UK domiciled/non long term UK resident recipients, such transfers are exempt from IHT and therefore do not use up any of the deceased's IHT allowance. In the past, this was tax inefficient as the estate of the surviving spouse would increase (quite often substantially) but when they passed away they would only have the basic IHT allowance to set against the value of their estate, thereby increasing the likelihood that IHT would become payable.

To address this issue, new rules were introduced so that provided one spouse was alive on or after 9th October 2007, any part of unused IHT allowance on the first spouse's death could be transferred and used to increase the allowance available to the surviving spouse/civil partner in the year that they pass away. If one spouse/civil partner dies and leaves everything to the other, the amount available for transfer is 100 per cent. Had the first spouse/civil partner left 25 per cent of their estate to the children, the appropriate percentage of unused allowance would be 75 per cent.

Whenever the surviving spouse/civil partner dies their IHT allowance may be increased by the percentage as calculated above. If, therefore, the IHT allowance when the second spouse/civil partner dies was £350,000 and the percentage unused on the first death was 100 per cent, the available IHT allowance for the survivor would be doubled to £700,000, provided that the requisite claim is made. It is important to note that it is the percentage of the unused allowance that is transferred, not the unused monetary amount.

Any claim (supported by various documentation) needs to be made by the executors and a two-year time limit applies. This two-year limit commences from the end of the month in which the second spouse/civil partner dies.

Similarly, and from 2017/18, it is possible to transfer any unused residence nil rate band (RNRB) provided that one spouse/civil partner was alive on or after 6th April 2017. It is important to note that the allowance may only be offset against the value of the residence – it is not possible to offset any unused allowance against the value of other assets forming part of the estate unless the special downsizing relief rules apply.

Do I still have to pay IHT if I die without a will?

IHT still generally applies to estates where the owner has died without leaving a will. However, dying intestate (without a will), does bring special rules into play. The statutory intestacy rules determine which members of the family inherit any assets. You can check your entitlement here.

In this situation, the assets of the estate are deemed to pass in a set manner according to how assets are held and who, if anyone, remains by way of next of kin. This may, of course, be undesirable for tax and other reasons and it may therefore be agreed by the beneficiaries to enter into a deed of variation.

I have heard about a deed of variation. What does it mean?

A deed of variation is a way by which the beneficiaries (those who inherit the assets) of an estate under a will, or under the rules of intestacy, may agree to change the terms of the will or the rights under the intestacy. This may be done to reduce tax, such as IHT, or to provide for someone who may have been left out.

Provided that the deed of variation is completed within two years from date of death then for IHT purposes the new beneficiaries are treated as acquiring the assets as at the date of death and as if this had been done following the wishes of the deceased.

Deeds of variation may have the effect of reducing an IHT liability by perhaps transferring more of the estate to a surviving spouse/civil partner or some other exempt beneficiary such as a charity. Conversely a deed may increase an IHT liability if the former decide that they would rather let the children have more. If the IHT liability is altered, HMRC will require a copy of the deed of variation within six months of it having been made.

If I make gifts now will I be protected from paying care home fees?

This is one of the most frequently asked questions and one where callers sometimes have the most confusion. In such cases the seven-year rule (above) has no relevance for the assessment of care home fees.

The payment of care home fees invariably take into account the assets of the individual requiring care. Whilst the transfer of assets to another family member may be effective for IHT purposes in reducing the value of their estate, it is not necessarily the case that it will reduce the assets for a care home fee assessment. Where an individual is deemed to have deliberately divested themselves of assets to get around or reduce the amount of care home fees, these assets can be treated as if the transferor still retained them and any assessment will be made on that basis.

There are no rules with regard to how long ago a transfer needs to have taken place to fall foul of the deprivation of assets rules and each case will be considered on its merits.