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# SPOTLIGHT ON:

Inheritance tax essentials  
for 2025/26



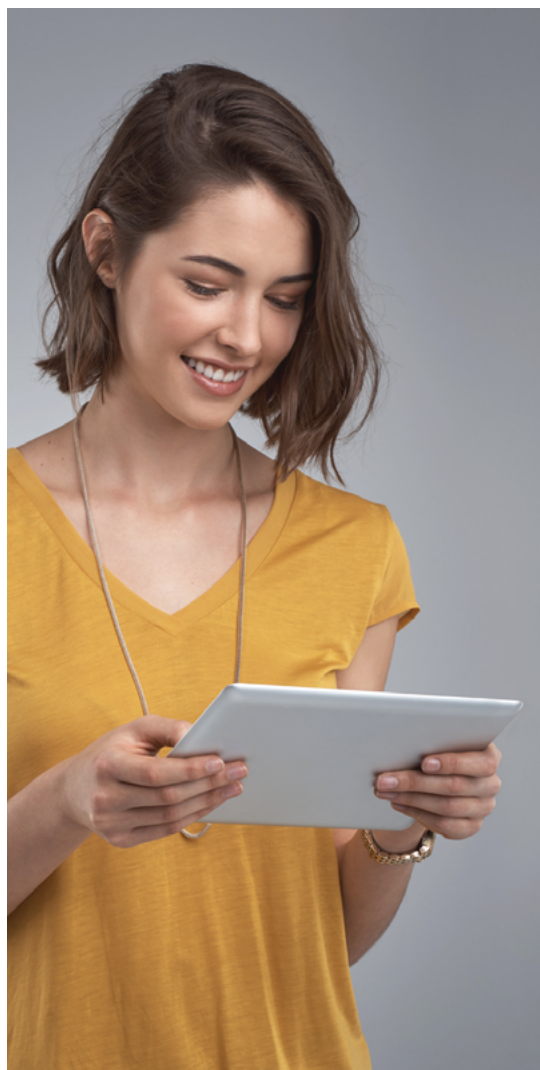


# STRATEGIES FOR MINIMISING IHT LIABILITIES

Inheritance tax (IHT) in the United Kingdom applies to the transfer of wealth after death. It can affect property, savings, investments, and other assets. Although it applies to a smaller portion of estates, those crossing certain value limits may face a 40% tax charge on amounts above available allowances. Thresholds have been frozen for several years, so rising asset prices can bring more families into scope.

This guide reviews the 2025/26 allowances, rates, and reliefs and outlines legal provisions under HMRC regulations. It offers factual, compliance-based guidance for individuals and families who wish to manage their affairs effectively.





## CURRENT THRESHOLDS AND RATES

- **Nil-rate band (NRB):** £325,000 per individual. This level has not changed for several years and remains frozen for 2025/26. Estates valued below £325,000 pay no IHT. Amounts above this threshold are generally taxed at 40%.
- **Residence nil-rate band (RNRB):** £175,000 per individual, available when a home is left to direct descendants (children, stepchildren, adopted children, or grandchildren). If the RNRB applies, it can raise a person's overall tax-free allowance to £500,000 (i.e. £325,000 plus £175,000).
- **Taper for RNRB:** If the total estate exceeds £2 million, the RNRB is withdrawn by £1 for every £2 above £2m. High-value estates may lose some or all of the £175,000 allowance.

- **Spouse and civil partner exemption:** Transfers between spouses or civil partners are exempt from IHT, regardless of amount. The first spouse's unused NRB can pass to the survivor. This can double allowances to £650,000 (2 × £325,000) or up to £1m (2 × £500,000) if the RNRB is fully used.
- **Rate of tax:** The standard rate is 40% on any value above the available allowances. This can drop to 36% if you leave at least 10% of your net estate to charity.

These thresholds are set to remain in place until at least April 2030. Since property and investment values continue to rise, individuals who might not previously have worried about IHT may now need planning advice.

## LIFETIME GIFTS AND EXEMPTIONS

A common way to lower IHT liability is to pass on assets while still alive. Some gifts are instantly exempt, while others become exempt over time:

### ANNUAL GIFT EXEMPTION

- Each individual can give away up to £3,000 per tax year free of IHT. This amount can go to one person or be split among several recipients.
- If the full £3,000 exemption goes unused in a particular tax year, it can carry forward one year (up to £6,000 maximum). After that, any unused portion expires.

### SMALL GIFTS EXEMPTION

- You can give any number of gifts up to £250 per recipient each tax year, and these are immediately exempt as long as no other exemption is used for the same person that year.
- This applies well to small, customary presents for special occasions.

### WEDDING OR CIVIL PARTNERSHIP GIFTS

- Gifts made on the occasion of a marriage or civil partnership are exempt up to certain limits: £5,000 for a child, £2,500 for a grandchild, and £1,000 for anyone else.
- You can combine this exemption with the £3,000 annual exemption.

### REGULAR GIFTS OUT OF INCOME

- If you have surplus income, you can set up a pattern of gifts from after-tax income without affecting your normal standard of living. These are free of IHT immediately.
- Proper documentation is important: your executors should be able to show that the gifts came from income and did not erode your capital.

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### **POTENTIALLY EXEMPT TRANSFERS (PETS) AND THE SEVEN-YEAR RULE**

- Gifts above the specific exemptions above are known as PETs. They incur no IHT if the donor survives for seven years.
- If the donor dies within seven years, the gift may be added back into the estate, potentially creating a tax liability. However, taper relief can reduce the IHT rate on that gift if death occurs more than three years after the donation.

### **GIFT WITH RESERVATION OF BENEFIT**

- You cannot keep using or benefiting from an asset you have supposedly “gifted.” For instance, giving a house to children but continuing to live there without paying market rent would not remove the property from your estate for IHT.
- The gift must be genuine and unconditional for it to leave your estate.

By making gifts early and consistently, an individual can reduce the size of their taxable estate. The seven-year window for larger transfers (PETs) is important to keep in mind. Good record-keeping is essential for executors to show HMRC the timing and nature of any gifts.

## TRUSTS

Trusts can provide a structured way to transfer or protect assets. Different trust types follow specific IHT and tax rules:

### BARE TRUSTS

- A bare trust gives the beneficiary an immediate, absolute right to the assets. It is often used for minors until they reach adulthood.
- For IHT, putting assets in a bare trust counts as a PET. If the donor survives seven years, the gift is fully exempt.

### DISCRETIONARY TRUSTS

- Discretionary trusts allow trustees to decide which beneficiaries receive income or capital. No beneficiary has an automatic right.
- When establishing or adding assets to a discretionary trust, any amount above your available nil-rate band can be taxed at 20% (the lifetime rate).

If you die within seven years, that may rise to 40%, with credit for the 20% already paid.

- Discretionary trusts face a “periodic charge” (up to 6%) every ten years on the value above the nil-rate band, and there may be an “exit charge” of up to 6% when assets leave the trust between those anniversaries.

### WILL TRUSTS

- Assets can pass into a trust when someone dies, based on the terms in their will.
- In the past, couples sometimes used nil-rate band discretionary trusts in their wills so the allowance of the first spouse was not wasted. However, since the nil-rate band can now be transferred between spouses, that is less common for the sole purpose of using the band. Trusts in wills remain helpful for more complex family arrangements or controlled distribution.

### REASONS TO USE TRUSTS

- They allow control over how and when beneficiaries receive assets.
- Once assets have been correctly placed in trust for long enough (and any relevant IHT on entry paid or avoided through exemptions), future growth often sits outside the settlor’s estate, which may reduce IHT in the long run.

Trusts require careful drafting and administration. Specialist advice is often advisable to ensure the trust is set up in line with current tax laws.

## BUSINESS AND AGRICULTURAL RELIEFS

Certain businesses and farms benefit from substantial IHT relief, preventing a situation where heirs must sell assets to cover the tax.

### BUSINESS RELIEF (BR)

- Some or all of a trading business can be passed on free of IHT, depending on qualifying criteria.
- Ownership of an unlisted trading company or partnership interest may attract 100% relief if held for two years.
- Assets such as land or machinery personally owned but used by the business can attract 50% relief.
- Businesses that focus on investment rather than trading (e.g. property letting) usually do not qualify.
- From April 2026, BR will be capped so that only the first £1 million of qualifying business assets (or interests) benefits from the relief.

### AGRICULTURAL PROPERTY RELIEF (APR)

- Aims to protect working farms. Farm property, farmhouses, and buildings used for agriculture may receive up to 100% relief, depending on ownership duration and use.
- The agricultural value of the property is exempt, but extra development value might not be covered.
- From April 2026, a cap will apply so that only the first £1 million of qualifying agricultural property benefits from full APR, with reduced relief available above that threshold.

These reliefs can significantly reduce the taxable part of a deceased's estate by ensuring conditions are met (such as maintaining a genuine trading status or continuing active farming). Ownership time frames are key – most often, two years of ownership is required for 100% relief.

## PENSIONS

Defined contribution pensions usually lie outside the estate for IHT purposes, making them a significant opportunity for wealth transfer:

- **General treatment:** Because most pension schemes are set up with discretion for trustees over death benefits, the funds are not considered part of the estate for IHT.
- **Before vs. after age 75:** If death occurs before 75, a nominated beneficiary may inherit pension funds tax-free (no income tax and no IHT). If death occurs after 75, the beneficiary pays income tax at their marginal rate when drawing from the inherited pot, but there is still no IHT on the fund.
- **Practical approach:** Many retirees choose to spend non-pension assets first, leaving the pension to grow or remain invested, as it can transfer to heirs with minimal tax consequences.
- **Potential future changes:** The government has indicated it may review these rules, especially from 2027 onwards, but for 2025/26, defined contribution pensions generally remain outside IHT.

By clearly nominating beneficiaries, individuals can ensure their pension passes smoothly, often free of inheritance tax. Given the freeze on other allowances, this is a popular planning tool.







## CHARITABLE DONATIONS

Leaving part of an estate to charity can reduce or remove inheritance tax on the donated sum and, in some cases, lower the rate on the rest of the estate:

### CHARITY EXEMPTION

- Any assets left to a registered UK charity are fully exempt from IHT. This portion does not affect the nil-rate band.
- For example, leaving £50,000 to charity reduces the taxable estate by that amount.

### REDUCED 36% RATE

- If 10% or more of the net estate (after allowances and deductions) goes to charity, the IHT rate on the remaining taxable estate is cut from 40% to 36%.
- Therefore, the effective cost of donating that 10% is partly offset by the lower tax on the rest.

Some people choose to combine these two benefits, both supporting philanthropic causes and reducing the overall tax their heirs might face.

## OTHER STRATEGIES

### LIFE INSURANCE IN TRUST

- A life insurance policy (often a whole-of-life plan) can be used to cover any IHT bill. Writing the policy in trust means the payout falls outside the estate and is paid promptly to the beneficiaries or trustees, who can then settle the tax.
- This approach does not reduce the IHT itself, but it removes the need for beneficiaries to raise cash – often a problem if most wealth is in property.

### EQUITY RELEASE

- A homeowner can take out a lifetime mortgage to unlock cash from their property. This debt reduces the estate's net value, and the homeowner might gift the released funds (which could be exempt if they survive seven years).

- The accumulating interest on the loan will further lower the estate's final value. This can help reduce or avoid IHT, although it also means less equity remains for beneficiaries.

### FAMILY INVESTMENT COMPANIES (FICS)

- A private company structure can allow parents to transfer shares to their children without giving them immediate control over the assets.
- Shares given to children count as potentially exempt transfers. If the parents survive seven years, the shares do not return to their estate.
- Parents typically retain voting (but low-value) shares, so future growth accrues to the children's shares, helping to limit the parents' taxable estate.

### WILLS AND REGULAR REVIEWS

- A valid will is essential to use allowances and reliefs effectively.
- As personal or legislative circumstances change, reviewing IHT plans periodically helps to keep strategies up to date.

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## THE VALUE OF PROFESSIONAL GUIDANCE

While some estates remain below the IHT thresholds, many property owners now find themselves close to or over these limits. Families can mitigate or eliminate the 40% tax on amounts above the nil-rate bands by focusing on legitimate allowances, reliefs, and planning structures.

Early, informed action is the foundation of effective IHT planning. By reviewing current rules, seeking professional guidance, and monitoring any legislative changes, individuals can ensure their estate plans remain aligned with their wishes. Regular updates can help owners respond to shifts in property values, personal circumstances, and policies, allowing them to preserve more of their assets for future generations.



**Regularly reviewing your inheritance tax plan can help you adapt to legislative changes and protect your assets. We're here to help.**



Newry, Co. Down, BT34 1DN