



August 2025

INHERITANCE TAX: AN OVERVIEW

Inheritance tax (IHT) is charged on chargeable transfers made by an individual during their life and on the value of their estate on death.

Tax is charged at 40% on death and at 20% on lifetime chargeable transfers to the extent that a person's estate or the lifetime transfer exceeds the nil-rate band. There are various reliefs and exemptions available which can reduce the overall amount of IHT due.

UK long-term residents are chargeable to IHT on their worldwide assets. Non-UK long-term residents are only subject to IHT on UK situs assets and certain non-UK assets whose value is related to UK residential property.

Where an individual has been UK resident for at least 10 out of the last 20 tax years immediately preceding the tax year in which a chargeable event arises they will be a long-term resident and non-UK assets will be in the scope of IHT. Such assets will remain within the scope of IHT for tax years after the individual ceases to be tax resident for a minimum of three years and up to ten years depending on how long they were resident in the UK before leaving.

LIFETIME PLANNING

Making outright lifetime gifts is one option for those who can afford to give away substantial assets. Provided the donor survives seven years from the date of the gift the assets are outside their estate. These are potentially exempt transfers (PETs). If the donor dies within seven years, the gift may be taxed, but taper relief applies, reducing the tax rate for gifts made between three and seven years before death.

Offshore insurance bonds allow for IHT planning as they are usually structured as a number of smaller policies or 'segments' and individuals can gift them to children or other beneficiaries.

Consideration can be given to setting up a family investment company (a FIC) which allows individuals to pass wealth down to the next generation while still retaining control over the assets and providing a flexible structure for managing the family wealth.

Insurance against the potential IHT exposure on death might also be an option for some to consider.



EXEMPTIONS

Making full use of available exemptions is also an important part of lifetime and estate planning.

- + **Spouse or civil partner exemption:** Transfers between spouses or civil partners are completely exempt from IHT. This means that a person can make lifetime gifts and leave their entire estate to their spouse or civil partner without incurring any IHT. There is a caveat to this, the exemption is restricted if the donor is UK long-term resident but the receiving spouse or civil partner is not. In such circumstances, the receiving spouse or civil partner has the option to elect to be treated as long-term resident for IHT purposes and so is able to benefit from the full exemption. Careful consideration would need to be given before making such an election as it would bring the survivor's worldwide assets within the scope of IHT.
- + **Charitable donations:** Gifts to registered charities are exempt from IHT and this applies to lifetime gifts and gifts left by Will. If 10% or more of the estate is left to charity, the IHT rate on the remaining estate can be reduced from 40% to 36%. As a result of the rate reduction, those minded to leave 4% or more of their estate to charity can increase the gift to 10% of their estate with no loss in the overall amount which their beneficiaries will inherit.
- + **Normal expenditure out of income:** Lifetime gifts are exempt if they form part of the donor's normal expenditure out of taxed income, provided that the donor is left with sufficient income to maintain their usual standard of living. A regular pattern of giving is required, for example meeting school fees for a grandchild or paying the premiums on a life policy for another's benefit.

Individuals can make use of a number of other smaller exemptions.

- + **Annual exemption:** Up to £3,000 can be given away per year. If the allowance is not used in any year, it can be carried forward, allowing for an IHT-free gift up to £6,000 in the following year.

- + **Small gifts exemption:** Up to £250 can be given to any number of individuals each year, provided no other gifts have been made to them in the same year. This exemption is typically used by grandparents to give away sums free of IHT each year on occasions such as birthdays or at Christmas, although it is available to everyone and gifts do not have to be made to relatives.
- + **Marriage and civil partnership:** Lifetime gifts on the occasion of a marriage or registration of a civil partnership are exempt up to certain limits. The amount of the exemption depends on the relationship of the donor to the couple. Each parent can give £5,000, each grandparent (or remoter ancestor) can give £2,500 and any other person can give £1,000.

NIL-RATE BAND

The nil-rate band is the amount up to which lifetime chargeable gifts not otherwise exempt can be given free of tax, or the amount up to which an estate is not subject to IHT. This is currently set at £325,000 and due to remain fixed at this level until 2028. Estates (including any gifts made within the seven years before death) valued below this amount are not taxed.

The nil-rate band effectively refreshes every seven years.

If the first spouse or civil partner dies and does not use their full nil-rate band (for example by leaving everything to their surviving spouse or civil partner), the unused portion can be transferred and used by the survivor's estate.

This means that when the second person dies, their estate can benefit from a combined nil-rate band of up to £650,000.



RESIDENCE NIL-RATE BAND

The residence nil-rate band provides an additional tax-free allowance of £175,000 for estates that include a home which is left to direct descendants (i.e. children, grandchildren and stepchildren).

As for the nil-rate band, if the residence nil-rate band is not used in full on the death of the first spouse or civil partner the unused amount can be transferred to the survivor. Meaning that a couple could have a total £1 million allowance to set against the estate on the second death.

However, importantly, the residence nil-rate band is reduced by £1 for every £2 that the estate exceeds £2 million. Therefore, estates over £2,350,000 will not benefit from this relief.

RELIEFS

- + **Business Property Relief:** This relief applies to certain business assets, potentially reducing the value for IHT purposes by 50% or 100%. Qualifying assets include shares in unlisted companies, partnership shares and other business assets.
- + **Agricultural Property Relief:** Agricultural property can qualify for up to 100% relief from IHT. This includes farmhouses, farmland and farm buildings, provided they are used for agricultural purposes.

It was announced at the October 2024 Budget that these valuable reliefs will be greatly reduced with effect from 6 April 2026. Individuals will have a total allowance of only £1 million for business or agricultural assets benefitting from relief at 100% and then there will be relief at 50% for all assets above that amount. AIM listed shares (currently relieved at 100%) will also only be relieved at 50%. The £1m allowance will refresh every seven years in a similar way to the nil-rate band.

TRUSTS

Trusts can be used to manage assets and potentially reduce IHT liability. There is a 20% entry charge to the extent that the gift into trust exceeds the nil-rate band unless an exemption applies. A couple who has not made any gifts in the previous seven years could put £650,000 into a family trust every seven years.

Those with assets qualifying for 100% business or agricultural property relief might consider putting them into trust up to the £1 million allowance, or in excess of that amount but facing a reduced 10% entry charge on the value over £1 million. The normal expenditure out of income exemption can be used to relieve additions into trust.

The settlor will need to be excluded from benefiting under the trust to avoid the gift with reservation of benefit rules which would treat the assets as still being comprised in their estate and so subject to an IHT charge on death.

The trust itself will be subject to IHT with the ten-year periodic charge (at currently no more than 6%) and exit charges when assets pass to beneficiaries.



OUR TEAM



JONATHAN CONDER

Partner, London

+ 44 20 7809 2015
jonathan.conder
@stephensonharwood.com



ROSS DAVIDSON

Partner, Hong Kong

+ 852 2533 2868
ross.davidson
@stephensonharwood.com



JORDAN ELLIS

Partner, Dubai

+ 971 56 793 1798
jordan.ellis
@stephensonharwood.com



ALASTAIR GLOVER

Partner, Dubai

+971 56 547 7766
alastair.glover
@stephensonharwood.com



SUZANNE JOHNSTON

Partner, Singapore

+ 65 6622 9649
suzanne.johnston
@stephensonharwood.com



RONNIE MYERS

Partner, London

+ 44 20 7809 2472
ronnie.myers
@stephensonharwood.com



BEATRICE PUOTI

*Partner, Head of Private
Wealth, London*

+ 44 20 7809 2823
beatrice.puoti
@stephensonharwood.com



JAMES QUARMBY

Partner, London

+ 44 20 7809 2364
james.quarmby
@stephensonharwood.com



MICHAEL RUTILI

Partner, London

+ 44 20 7809 2022
michael.rutili
@stephensonharwood.com



CAROLYN O'SULLIVAN

*Senior Knowledge Lawyer,
London*

+ 44 20 7809 2418
carolyn.o'sullivan
@stephensonharwood.com