

# A guide to Inheritance Tax and Estate Planning



# STEP

ADVISING FAMILIES ACROSS GENERATIONS

## *Important Note*

This guide is intended to be an introduction to this extraordinarily complex area of financial planning and should not be relied upon without personalised legal and tax advice.

## Introduction

I am a Registered Trust & Estate Practitioner and have been advising on Wills, Trusts, Probate, and Estate Planning since 1971. As a qualified member of the Society of Trust & Estate Practitioners (STEP), I comply with their Code of Professional Conduct. I am a former Chair of STEP Yorkshire.

Inheritance Tax (IHT) has been with us in some form since 1694 when it was known as Probate Duty and became IHT in three stages - Estate Duty (1894), Capital Transfer Tax (1975), and IHT (1986). Since 1986, IHT has been tweaked by most Chancellors of the Exchequer to make it one of the most complicated death duties in the world. The more significant landmarks were the introduction of the Transferable Nil Rate Band in 2007 and the Residence Nil Rate Band ten years later.

Famously, Roy Jenkins, one of Labour's Chancellors of the Exchequer, said, "Inheritance Tax is a voluntary levy paid by those who distrust their heirs more than they dislike the Inland Revenue."! This is intended to guide the reader through some of the legitimate ways of making this a reality.

It is important to remember that only 4% of estates in 2023 were liable to IHT but that percentage is growing year-on-year as asset values increase whilst some thresholds have remained frozen since 2009. If you are in that 4% - total assets over £325,000 for a single person or up to £1m (generally at least £650,000) for a couple (married/Civil Partnership) – and you want to maximise the legacy you leave, read on.

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## Important note

The impact of taxation (and any tax reliefs) depends upon your individual circumstances. The information in this guide is based on the author's understanding and interpretation of current UK tax law and HM Revenue & Customs (HMRC) practice as at the date of publication. In relation to any other legal matter, references are to England (& Wales) Law, which could be different in Scotland & Northern Ireland.

References throughout this guide to "spouse", includes Civil Partners.

## How much is IHT?

IHT is essentially a tax on the estate of someone who has died, including all property, possessions, and money (less funeral costs and any outstanding liabilities).

It is usually charged at 40% of the net value of everything in your estate that exceeds your available Nil Rate Band (NRB).

There is normally no tax to pay if:

- The net value of your estate is below the available NRB
- You leave everything to your spouse
- You leave everything that might be taxable to an exempt beneficiary, such as a charity

The main things that may increase the tax payable are:

- Gifts to individuals or Trusts within the last 7-years
- If you are the beneficiary of certain types of Trust
- If you and your spouse are not both deemed resident in the UK

The main things that might reduce the tax payable are:

- Having certain business or agricultural assets
- If you are not deemed resident in the UK and have non-UK assets
- If you have previously been bereaved through the death of a spouse
- You leave part of your estate to an exempt beneficiary, such as a charity



## What is the NRB?

The current NRB threshold for IHT is £325,000. Upon your death, no tax will be charged on the net value of your estate up to this amount.

The NRB was set at £71,000 in 1986 and was increased in most Budgets until the current threshold was reached in 2009. Currently, it is set to remain frozen at the 2009 level until 2030.

If you are widowed, then the percentage of any unused NRB of a deceased spouse can be transferred to you, for use upon your death. This means your estate could have up to a £650,000 NRB.

## What is the Residence NRB?

This additional NRB, introduced in 2017, increases the threshold for those people leaving their home to “direct descendants”. The definition of “direct descendant” is broad and includes not only children, grandchildren, etc., but foster, wards, stepchildren, and their spouses.

The amount of the Residence NRB is the lesser of £175,000 or the value of the interest in the home. It was introduced at £100,000 in 2017 and increased in stages to £175,000 in 2020 but has remained frozen since and is set to remain at this level until 2030.

In common with the NRB the Residence NRB is transferable between spouses, if unused on the first death (even if that death occurred pre-2017). This means that a couple with a property valued at £350,000 or more, which is left to direct descendants, could have a total NRB of £1m.

There is, however, tapering of the Residence NRB if the total estate, before the application of any Business or Agricultural Relief exceeds £2m, with the band reduced by £1 for every £2 the estate exceeds the threshold. Consequently, for an estate of £2,700,000 comprising a qualifying property valued at £350,000 or more, there is no Residence NRB.

There is downsizing relief for those selling a qualifying property on or after 8 July 2015, meaning the proceeds of sale can be substituted for the value of the replacement home, up to £175,000. If there is no replacement property, the relief can still be claimed if assets of sufficient value are passed on death to direct descendants.



## IHT calculation

Mary was widowed in September 2014 and inherited the entire estate from her husband, Arthur.

In July 2020 Mary sells the family home for £500,000 and buys an apartment for £200,000. At the time of her death in March 2025 her estate comprises net assets of £1m, including her apartment at £250,000, and savings and investments of £750,000, which is left, by her Will, equally to her five grandchildren.

The first £650,000 is tax-free by virtue of Mary and Arthur's NRBs but, without downsizing relief, the Residence NRB would be restricted to £250,000, meaning her estate exceeding the available NRBs by £100,000, giving rise to an IHT charge of £40,000. However, downsizing relief reinstates the maximum Residence NRB, meaning Mary's entire estate is tax-free.



## Who pays any IHT?

Generally, it's the Personal Representatives – Executors, if there's a Will, or Administrators, if there isn't – who pay the IHT at the point of applying to Probate of the Will or Letters of Administration.

IHT can be payable on lifetime gifts into most types of Trust if that gift exceeds the available NRB. The tax charge is at 20% of the excess over the NRB. IHT can also become payable by the Donee of gifts within 7-years of death which exceed the NRB, with tax at 40% on the excess.

## When is IHT due?

As stated above, IHT is payable upon the application for Probate or Letters of Administration but is only interest-free if paid within 6-months of death. Any tax unpaid is subject to an interest charge of 4% above Bank of England Base Rate.

Executors and Administrators can access funds held by banks, building societies, and most investment companies for them to pay funds directly to HMRC for the IHT liability. This is prior to the application for Probate/Letters of Administration, which can save a lot of hassle and interest.

IHT on large properties or property portfolios can be paid in instalments over 10-years, but with interest accruing at 4% over Bank of England Base Rate, this could be expensive.



## What can you do about IHT?

The key is early intervention. Much of the IHT planning relies on the donor surviving 7-years from the date of the gift, so the earlier you start, the less likely it is for you to fall foul of this.

A combination of the following may be relevant:

- Spending it - “skiing” (spending the kids’ inheritance)
- Giving it away – outright or via a Trust
- Stopping the problem getting worse
- Investing in exempt assets
- Pre-funding via Life Assurance
- Ensuring your Will is as tax efficient as possible

There's an adage in financial planning of, “Don't let the tax tail wag the investment dog”. In other words, don't do something just because it saves tax if it doesn't make sense in terms of your own long-term goals.

To ensure your spending or gifting plans aren't likely to leave you “high and dry” and unable to maintain your desired standard of living, ask your financial planner to prepare a cash flow analysis for you. If you don't have a financial planner, or if your financial planner doesn't offer cash flow planning, then ask me to introduce you to Wren Sterling.

If your affairs are complex, particularly, if you have shares in an unquoted company, a working farm, or a large property portfolio, I work with accountancy and taxation experts who can help with more sophisticated planning.



## Giving it away - Gifts

Some gifts are exempt from IHT, whilst others are subject to the “7-year rule”.

### Exempt gifts

#### Annual Exemption

If you think freezing the NRB since 2009 is mean, how about the Annual Exemption and its associated exemptions, which have remained unaltered since 1986!

The Annual Exemption is £3,000 per Tax Year which, if unused, can be carried forward for one-year only.

#### Additional exemptions include:

- Small gifts of up to £250 each to any number of individuals (excluding any benefitting from the Annual Exemptions)
- On the occasion of a marriage - £5,000 (child); £2,500 (grandchild); £1,000 (anyone else) in addition to any Annual Exemption

#### Regular gifts out of income

IHT is a tax on capital, not on income. Consequently, if you have surplus income (demonstrably over and above your expenditure in that Tax Year) you can give this away regularly, in addition to any Annual Exemption, tax-free.

Payments made monthly or seasonally are clearly regular, more ad hoc arrangements need additional planning and recording.

Such gifting doesn't reduce the potential tax liability, but it does help preventing the problem getting worse.

If the exemptions are used to fund premiums for a Whole of Life contract (joint life, second death for couples), this can be seen as a cost-effective means of saving tax-free to provide a fund, via a simple Trust, to compensate beneficiaries for the tax charge on your estate.

### Charitable gifts

Most gifts you make to registered UK charities during your lifetime or via your Will are exempt from IHT.

For taxpayers, lifetime gifts can benefit from Gift Aid, which increases the amount gifted to the charity by 25%, whilst extending your Basic Rate Income Tax Band. Via your Will, gifts are exempt, and, if the amount gifted exceeds 10% of the taxable estate (net estate less available NRBs), not only are those gifts exempt, but the rate of IHT charged on the balance of the estate reduces from 40% to 36%.

### Potentially Exempt Transfers (PETs)

Gifts to individuals outside of these exemptions and allowances are PETs and subject to the 7-year rule; they are added back to your estate upon death if you fail to survive 7-years and they are a first call on any available NRB.



## Giving it away - Trusts

If beneficiaries are young, immature, disabled, in risk of getting divorced or made bankrupt, have a poor relationship with money, or there is any other impediment to an absolute gift, this is where Trusts come into their own.

The most usual form of Trust used in IHT planning is the Discretionary Trust. A Discretionary Trust names beneficiaries (or a class of beneficiaries - “my descendants”) without saying who has what and when. What and when are then at the discretion of the Trustees, hence the name.

If yours is a “traditional” family – mum, dad, children, grandchildren, etc., - then your financial planner will have access to an off-the-shelf Trust Deed pro forma which should suffice. If you are wanting to benefit anyone other than your own descendants – godchildren, nieces, nephews, etc., - then a bespoke Trust is recommended. I can draw one up for you via my relationship with Private Client Online at a reasonable fixed fee.

Best practice dictates that a “Letter of Wishes” accompanies the Trust Deed setting out what your intentions were when setting up the Trust, by way of guidance for the Trustees.

Lifetime Trusts, apart from Bare/Absolute and Disabled Persons Trusts, are “Relevant Property Trusts” and gifts are subject to IHT upon creation.

Chargeable Lifetime Transfers (CLTs), as they are called, are subject to IHT if the value exceeds any exemptions and the available NRB(s). Tax is payable at 20% on the excess. These Trusts have their own NRB (double if there are co-settlors) but are subject to Periodical and Exit IHT charges, effectively at 6% on anything exceeding the available NRB, upon distribution and/or each 10-yearly anniversary.

Like PETs, the 7-year rule also applies, with IHT applied at either 20% or 40% to any amount gifted to a Relevant Property Trust set-up within 7-years of death.

As with PETs, to be valid for IHT purposes, any gift into a Trust must not have any element of a “Gift with Reservation of Benefit” (GRoB). The most common example of this is folk wanting to gift their home to Trust but to continue living in it rent-free; the roof over your head is a GRoB. However, your financial planner will have access to a couple of specialist Trusts, which exploit the structure of some life assurance contracts and a well-established legal precedent known as a Carve Out (*St Aubyn v Attorney-General 1952*). These Trusts can either provide an immediate stream of regular income or provide a “back door” through which to recover some of the amount invested in the future. Known as Discounted Gift Trusts and Reversionary Interest Trusts respectively, these are tried, tested, and accepted by HMRC as not falling foul of the GRoB rules.

A Bare/Absolute Trust is commonly used for things like school fees for which access will be required whilst the beneficiary is young. The key disadvantage of these Trusts is that the beneficiary is entitled to the assets of the Trust upon attaining capacity, generally at age 18.

## Investing in exempt assets

If you own unquoted shares in a trading company (as opposed to an “investment” company) or a working farm, these can be exempt by virtue of Business and/or Agricultural Relief.

At the time of writing, Business and Agricultural Relief is unlimited, but from 06 April 2026, this will be limited to £1m per individual, on a “use it or lose it” basis, i.e. not transferable between spouses like the NRBs.

Also, at the time of writing, shares in trading companies quoted on the Alternative Investment Market (AIM) are classified as business assets for the purposes of the relief. However, also from 06 April 2026, they will no longer qualify but will benefit from a reduced rate of IHT of 20%.

Specialist investment managers offer access to portfolios of AIM shares and specialist companies qualifying for Business Relief as an “off-the-shelf” IHT solution. The key benefits are that the relief is established after just 2-years of ownership and access to the capital and any dividends generated is not restricted.

These investments are only available via a regulated financial adviser and are not for the fainted-hearted. I've talked previously about the “tax tail wagging the investment dog” and this is a case in point.

One of the leading managers quite aptly describes these as high-risk investments with all the usual caveats about falling values, loss of capital, greater volatility,

illiquidity (ability to sell). Additionally, there are no guarantees the relief will be achieved/maintained.

Certainly, nothing in this guide is intended to be a recommendation to invest, merely an indication of what is available.

If you don't have a financial planner skilled in this type of investment, and you are interested, please ask me to introduce you to Wren Sterling.



## Ensure you have a robust Will

### *Why bother?*

Your death will be a stressful time for your nearest and dearest without leaving them a financial headache as well.

If you are married with children, then it is quite possible your spouse won't get everything. Joint assets (held in an undivided form) pass by survivorship outside of your Will or the Laws of Intestate Succession, but anything you own individually is caught. If you die Intestate, your spouse will receive your personal possessions, £322,000 (increased from £270,000 in July 2023) and half the remainder, with your children receiving the other half at age 18.

There's an immediate IHT consideration because, if the half going to the children exceeds the available NRB(s) there would be tax payable.

There's also a couple of other issues to consider. Firstly, will your spouse remarry and, if so, are you happy that their inheritance from you isn't protected for your children? Secondly, there's the question of whether 18 is the right time for a potentially substantial inheritance for your children?

A Will can ensure everything benefits from spouse relief, is protected from remarriage, and can specify the age at which children should inherit.

### *IHT*

A will can ensure that the best use is made of any assets qualifying for Business/Agricultural Relief.

Also, as discussed earlier, a gift to charity can achieve substantial IHT savings.

I can draw one up for you via my relationship with Private Client Online at a reasonable fixed fee.

Please ask for a copy of my more comprehensive guide to Wills.

### *Deed of Variation*

A Deed of Variation can effectively re-write a Will or the Laws of Intestate Succession to make them more IHT-friendly, but this can only be done if all the beneficiaries have capacity. Also, it must be completed within 2-years of death. It's so much better to get the Will right whilst you're alive than trying to rectify oversights later.

I can draw one up for you via my relationship with Private Client Online at a reasonable fixed fee.



## Defined Contribution Pensions

### *Death Benefits*

The death benefits from a Defined Contribution (as opposed to a Defined Benefit - salary-linked) Pension are not dealt with by your Will. They will be dealt with by the pension provider at their discretion. Consequently, it is essential that you have completed an “Expression of Wishes” form to guide the provider in the exercise of their discretion.



Whilst the provider will always give precedence to a dependant (a spouse, for example, even if they are not a financial dependant), they will consider other nominees, especially with evidence of any dependant's financial independence at the time of death. The key point being that the options available to nominees are much broader, and potentially significantly more tax-efficient, than they are as simple beneficiaries. Consequently, it has been my normal practice to include children as well as the spouse as nominees.

### *IHT*

At the time of writing, pension death benefits are exempt from IHT, but, from 06 April 2027, they will be pulled into the calculation. Consequently, the nominations not only need to consider the family dynamic but also the IHT implications.

### *Income Tax*

There's a double whammy with pension death benefits if death occurs after age 75, as anything withdrawn by way of nominee pension benefits will be subject to Income Tax at the nominee's marginal rate. Prior to age 75 pension death benefits can be withdrawn tax-free.

## Summary & Conclusion

As I said on page 1, this is a brief guide to an extraordinarily complex topic and is only intended to be an introduction and basis for a discussion.

The process outlined here is:

- Assessment – have you got a problem and, if so, how big is it?
- Goals – is it important to you to mitigate this potential liability?
- Affordability – what can you afford to do without compromising your standard of living and providing for whatever the future may bring?

If you have an IHT problem and want to do something about it, please contact me for an appointment. The initial consultation is at your convenience, my expense, and without obligation.

I will send you my Terms of Business and Privacy Notice with the confirmation of any meeting arranged.

Prior to the commencement of any chargeable work, I will send you an Engagement Letter, with an estimate of the likely fees.

## Can the author help with other matters?

Personally, and in conjunction with other trusted partners, there are several legal and other matters the author can help with, including:

- Lifetime Trusts for gifts and loans
- Registering a Trust with HMRC
- Trust Administration
- Trust Investment
- Wills
- Applications for Probate
- Deeds of Variation
- Lasting Powers of Attorney (LPAs)
- Advance Directives

The above list isn't exhaustive, so if you have a question on any matter raised in this guide, or any other financial matter, please just ask. Remember, the only dumb questions are the ones you don't ask when you have the chance!

Contact me for help and advice on any of these and other related services. Any initial consultation is without obligation, at my expense and your convenience.

