Partners Wealth Management

An introduction to

Inheritance tax

Planning for your family's future, across generations

Introduction

Understanding how Inheritance Tax (IHT) works has become increasingly important for families, particularly with unused pension savings due to be brought into scope from April 2027.

Inheritance Tax (IHT) is paid when you die, based on the total value of your estate and any gifts made in the previous seven years. Although the tax is only charged on death, its impact can be significant — and without careful planning it may reduce the amount you pass on to those you care about.

It's easy to delay tackling IHT, but thoughtful planning can make a meaningful difference. With the right approach, you can protect more of your wealth for future generations.

How much is IHT?

If your estate is liable for IHT, the tax is usually charged at 40%. This applies to money, savings and other assets passed on when you die, and potentially to some gifts made during your lifetime. This rate reduces to 36% if at least 10% of your estate is left to charity.

How is it calculated?

IHT is calculated after deducting debts and funeral expenses. Your executors – or administrators if there's no will – are responsible for paying the tax from your estate with HMRC's approval. Once the tax has been settled, a grant of probate can be issued and the estate distributed to your beneficiaries.

What is the nil-rate band?

The nil-rate band (NRB) is the amount you can pass on without incurring IHT. This is currently £325,000 and has been frozen until April 2031. Since 2007, any unused portion of an individual's NRB can be transferred to a surviving spouse or civil partner. This means the second partner may be able to use a combined allowance of up to £650,000.

What is the residence nil-rate band?

The residence nil-rate band (RNRB) provides an additional allowance when you leave your main home to direct descendants. These can include children and grandchildren, including adopted, step or foster children.

Each person currently has an RNRB of £175,000, frozen until April 2031. Combined with the standard nil-rate band, this means a parent may be able to pass on up to £500,000 that includes a qualifying home.

If any of this allowance isn't used when the first partner dies, it can be transferred to the survivor – allowing couples to pass on up to £1m in total without being subjected to tax.

What about larger estates?

If you have an estate worth more than £2m, the RNRB (but not the NRB) is reduced by £1 for every £2 above this threshold. This tapering can reduce the RNRB to zero. However, as lifetime gifts are excluded from the calculation, there are opportunities to plan effectively.

Gifts and exemptions

Gifting can be a simple and effective way to reduce the value of your estate over time. Whether helping with school fees or passing on savings, different types of gifts receive different IHT treatment depending on their value, timing and recipient.

Annual exemption – you can give away up to £3,000 each tax year without incurring IHT. If you haven't used the exemption in the previous tax year, it can be carried forward once

Small gifts exemption – you can give up to £250 to any number of individuals each tax year, provided no other exemption is used for the same person

Normal expenditure out of income – some ongoing gifts can be immediately exempt from IHT if they form part of your regular expenditure, are made from income (not capital), and do not reduce your standard of living. This can be particularly helpful for families supporting grandchildren with ongoing costs such as childcare or education

Wedding gifts – You can also make IHT-exempt gifts for weddings or civil partnerships:

- Parents can gift up to £5,000
- Grandparents can gift up to £2,500
- Well-wishers can gift up to £1,000

Larger gifts and the seven-year rule

Gifts that are not immediately exempt are known as potentially exempt transfers (PETs). These fall outside your estate for IHT purposes if you survive for seven years after making them. If you die within that period, taper relief may reduce the tax due on larger gifts.

When making significant gifts, it's important to avoid the "gift with reservation" rules – which apply if you continue to benefit from an asset after giving it away. For example, giving your home to your children while continuing to live in it may not be effective unless you pay a commercial rent. Large gifts can be a complex area, so expert advice is essential.

How do the new residency rules apply?

From 6 April 2025, the rules for IHT liability shifted from domicile to residence-based rules.

This means that UK-situated assets will remain within the scope of UK IHT. However, whether your non-UK assets are subject to IHT now depends on your long-term UK residence — specifically, whether you have been UK-tax-resident for at least 10 of the previous 20 tax years.

This is determined by the Statutory Residence Test, which focuses on your UK days and ties, not your heritage.

A key impact is that you could become subject to worldwide IHT more quickly than under the old “deemed domicile after 15 years” rules. Equally, with domicile no longer relevant for IHT, long-term non-residence may make it easier for some people to lose their worldwide UK IHT exposure over time.

We’re here to help

Thoughtful planning can make a meaningful difference to the amount of IHT your estate pays — helping more of your wealth reach the people and causes that matter most. We’d be happy to discuss what this could mean for you in practice.

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Top Tips

Make a gift each year

Using your annual exemptions consistently can reduce the value of your estate over time. We recommend keeping a record of how much you have gifted, to whom and when it was made, this will help your executors to claim your exemptions.

Use a trust to cut your IHT

Cash, investments or property can be placed in a trust – provided neither you, your spouse nor dependent children benefit – and removed from your estate for IHT purposes. Trusts can be a helpful way to support family members, such as paying for a grandchild's education, but they involve complex rules, so specialist advice is important.

Consider life assurance

Life cover doesn't reduce IHT directly, but a policy written under trust can provide the funds your beneficiaries need to pay the bill. If premiums meet the criteria for "normal expenditure out of income," they will not be considered gifts.

Leave a gift to charity

You can reduce the rate at which IHT is payable by leaving at least 10% of your estate to charity. This would mean that the rate of tax payable on the balance of the estate could be reduced from 40% to 36%.

Business Relief

From 6 April 2026, the rules for Business Relief (BR) and Agricultural Property Relief (APR) will change. Estates will receive 100% relief on the first £1 million of qualifying assets, with any value above this amount attracting only 50% relief. In addition, Alternative Investment Market (AIM) shares and other "listed shares treated as unquoted" will be restricted to 50% relief regardless of value.

As these reforms significantly reduce the availability of full relief, early planning is essential – particularly for those affected by the transitional rules in place between now and April 2026.

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