



WILLOW TREE

FINANCIAL SERVICES



Your Guide To Inheritance Tax

“Inheritance Tax can appear to be complex, but with the right planning, you can reduce the impact it may have on your estate, and your loved ones.”

Your guide to Inheritance Tax

Inheritance Tax (IHT) is often mentioned but not always understood, affecting thousands of families each year. As it may not be the kind of legacy most people think of leaving behind, it's essential to plan ahead.

Many believe IHT is only for the very wealthy, but with rising property values, more estates are now impacted. By 2027-28, IHT is predicted to generate £9.10 billion in revenue, up from £8.66 billion.*

HM Revenue & Customs (HMRC) collected £8.5 billion from thousands of bereaved families in 2024-25.**

If your estate could face IHT, the good news is there are steps you can take now. Our guide outlines solutions to help you make informed decisions, with professional advice making all the difference.

Thank you for downloading this guide. If you have any questions along the way, please get in touch.

*<https://www.thisismoney.co.uk/money/pensions/article-14539135/Inheritance-tax-grab-OBR-forecasts.html>

**HMRC tax receipts and National Insurance contributions for the UK: statistics table, HMRC, 20 February 2026.

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The value of investments and the income they produce can fall as well as rise. You may get back less than you invested. Tax treatment varies according to individual circumstances and is subject to change.

“Inheritance Tax is charged on the value of assets someone leaves behind when they pass away. It can also apply to certain gifts made during their lifetime.”

Inheritance Tax: Understanding The Basics

What is Inheritance Tax?

Inheritance Tax (IHT) is charged on the value of the assets you leave behind when you pass away. Some gifts made during your lifetime can also be subject to IHT.

What is an Estate?

Your estate is everything you own at the time of your death. If you're married or in a civil partnership, you can leave your estate to your spouse or civil-partner tax-free. However, if you leave it to others, it may be liable for IHT.

What's the Threshold for Inheritance Tax?

IHT doesn't apply to everyone. If your estate is worth over £325,000 (the 'nil-rate band'), anything above this is taxed at 40%. If you leave 10% or more of your estate to charity, that tax rate reduces to 36%.

If passing on your main residence to direct descendants, an additional £175,000 allowance may be able to be claimed due to the Residence Nil-Rate band. More on this later in this guide.

What Assets are Included in an Estate?

Your estate includes your home, savings, investments, life insurance policies, and any other assets. Some pensions may be excluded now, but from 2027 pensions will also be included.

How to Work Out What Your Estate is Worth

Start by adding up all your assets, then deduct debts like loans or mortgages. You can also subtract charitable donations and reasonable funeral costs from the total value.

If your estate is currently worth less than £325,000, there's no inheritance tax to worry about for now. However, keep an eye on any future changes in value. If your estate exceeds £325,000, the amount above this threshold will likely be subject to IHT.



IHT and Marital Status

How Marital Status Affects Inheritance Tax

Single

If your estate exceeds £325,000, any amount over this is taxed at up to 40%.

Married/Civil Partnership

Assets left to your spouse or civil partner are IHT-free, and their nil-rate band remains intact.

Widowed

When someone passes away, their unused nil-rate band can be transferred to their surviving spouse or civil partner. The survivor can then benefit from a combined £650,000 nil-rate band.

Unmarried Couples

You're treated as single, with separate £325,000 thresholds that can't be combined.

Example: Paul dies, leaving his entire estate (£500,000) to his wife Louise. Louise now has combined assets (£500,000 + £450,000 of her own): £950,000. Subtracting the combined nil-rate band (£950,000 - £650,000): £300,000 Louise's taxable estate. Louise's estate would be taxed at 40% (£300,000 x 40%): £120,000 inheritance tax bill.

“A new IHT allowance came into effect in 2017 called the residence nil-rate band. However, the number of people who will be able to leave an estate worth £1 million (or more) totally free of inheritance tax will likely be limited.”



Residence nil-rate band

The residence nil-rate band applies to the estates of people who die after 6 April 2017.

You must plan on leaving a home to your children or grandchildren.

The allowance was phased in and reached the maximum of £175,000 per person for deaths that occur after 6 April 2020 (£350,000 per couple).

Adding this to a couple's nil-rate band equals £1 million per couple.

The allowance is frozen at £175,000 until April 2031.

Who Can Claim the New Allowance?

Married couples and civil partners can potentially pass on up to £1 million, including their home, tax-free. However, certain conditions apply. The property must have been the deceased's residence and be passed to direct descendants. Those without a property or leaving assets to non-descendants won't benefit. For estates over £2 million, the allowance decreases. The full benefit applies only if the property is worth at least £175,000 per person.

What About Spousal Transfers?

If one spouse leaves their estate to the other, the surviving spouse can benefit from a combined nil-rate band of £650,000. Similarly, when the second spouse dies, their estate can claim double the residence nil-rate band, provided the first spouse didn't use it. To claim the full £1 million exemption, several conditions apply: one spouse must die after April 2020, the home must be worth over £350,000, it must be left to direct descendants, and the estate should be under £2 million.

“Changes made in 2014 impact how Inheritance Tax applies to certain pensions. Whether your estate benefits depends on two factors: the type of pension you've built over your lifetime and your age at the time of death. However, in April 2027 pensions will be added back INTO the estate.”

Leaving pensions as part of your estate


Apart from the State Pension, there are two main types of pensions:

Defined Benefit Pension

This type guarantees you a fixed percentage of your final salary for the rest of your life. The income generally goes to you and sometimes to your spouse if they outlive you. However, it usually can't be left to anyone else after you pass away. You might be able to exchange this for a lump sum of cash, but it's often not the best choice, so it's wise to get financial advice before deciding.

Defined Contribution Pension

With this pension, you save money into your pension fund during your working years, creating a lump sum by retirement. You can take up to 25% of this pot tax-free and use the rest to buy an annuity, which provides a lifetime income. Like the Defined Benefit Pension, the annuity typically can't be left to your heirs unless you buy specific pension annuities that include your beneficiaries. Since 2014, you can also "draw down" from your pension pot, using it to generate income instead of buying an annuity. If you haven't fully drawn down the pot when you die, it can usually be passed on to your beneficiaries.



**The age at
which you
die matters**

The situation between now, and April 2027

Your undrawn pension pot can now be passed on without inheritance tax. However, if your beneficiaries withdraw from it, they'll face income tax. If you pass away before 75, they won't pay any tax on withdrawals. If you pass away after 75, the tax they pay will depend on their income tax rate, which could be 20%, 40%, or 45%.

You'll pay income tax on any pension income you receive during your lifetime. Remember if you still hold the funds on death, the money you've drawn down will be included in your taxable estate when you pass away.

“It is possible to ‘gift’ your assets to others to reduce your IHT liability. However, there are some terms and conditions to be aware of.”

What's Changing?

From 6 April 2027, most pension death benefits will be included in your estate for IHT purposes.

Exceptions to the Rule

There are a few exceptions where pension death benefits will continue to fall outside of the estate for IHT purposes:

Dependants' Scheme Pensions: These are pensions paid to dependants of the deceased member and will remain exempt from IHT.

Charity Lump Sum Death Benefits: Payments made to a charity after the member's death will also be excluded from IHT.

How Will the Process Work?

The pension scheme will detail any death benefits and intended beneficiaries. Benefits paid to a spouse or civil partner will qualify for the spousal exemption and won't incur IHT. The pension scheme can pay any IHT due directly to HMRC before distributing the remaining benefits to the beneficiaries. Any additional income tax under pension rules will apply when the beneficiaries access the funds.

What Should You Do Now?

If your estate includes significant pension benefits, it's important to review your plans in light of these changes. Reassess how your pension fits into your overall estate planning. Consider the impact of these changes on your intended beneficiaries, especially if they are not a spouse or civil partner. Seek advice to explore other strategies for mitigating IHT liability on your estate.

Staying informed and planning ahead will be essential to navigate these upcoming rules. The inclusion of most pension death benefits in estates for IHT purposes represents a significant shift in estate planning. While exceptions exist, such as benefits for dependants or charities, this change may increase the IHT burden for many families.

Professional advice is more important than ever to ensure your estate is structured in the most tax-efficient way possible.



Gifts and the 7 year rule

Inheritance tax gifting exemptions

Any gifts between spouses or civil partners are exempt from IHT.

You also get an annual gifting allowance of £3,000, known as the 'annual exemption.' If you don't use the full amount in a year, you can carry over the unused portion to the next year, but only for one year.

You can give small gifts up to £250 each to as many people as you like, but you can't combine this with your annual exemption for the same person in the same year.

Wedding gifts are also free from inheritance tax, within certain limits: up to £5,000 for your child, £2,500 for a grandchild, £2,500 for your spouse or civil partner-to-be, and £1,000 for anyone else.

Additionally, gifts to charities, national museums, universities, the National Trust, political parties, and some other organisations like housing associations are not subject to inheritance tax.

Gifts can be free from inheritance tax if the giver lives for seven years after making the gift. If they die within that period, the gift's value is added to their estate, and the recipient will be responsible for any inheritance tax. There's a reduction in the tax rate, called 'taper relief,' if the giver survives between 3 and 7 years. However, taper relief only helps if the total gifts given in the seven years before death exceed the £325,000 nil-rate band.

“Trusts offer a way to control how your assets are distributed while potentially reducing inheritance tax, but they come with rules and tax implications that need careful planning.”



Let's talk
about
trusts

Setting up a trust

Trusts are a useful way to ensure your assets are passed to beneficiaries in a controlled manner, without triggering an inheritance tax bill. People often set them up to keep assets within the family across generations.

There are different types of trusts to suit various needs. For example:

You can leave assets to children or grandchildren but restrict access until they reach a certain age.

You can set conditions on how your estate is distributed to beneficiaries.

You can arrange for someone to receive income from your assets during their lifetime, while ensuring the assets eventually go to someone else.

Understanding the limitations of trusts

Trusts give you more control over where your money goes, but they can be tricky to set up. Since 2006, certain trusts face inheritance tax charges both when they're created and when assets are passed to beneficiaries, making large transfers into trusts less appealing.

For some trusts set up during your lifetime, assets take seven years to become exempt from inheritance tax—just like gifting directly to a beneficiary. If you pass away within those seven years, the assets in the trust will be added to your estate, and inheritance tax could be due if your estate exceeds the nil-rate band.

The breakdown of the different types of trusts

Discretionary Trusts

These are typically set up to provide for a group of beneficiaries, like children or grandchildren. The trustee manages the assets in the trust. For inheritance tax purposes, the assets are outside the estate if the person who set up the trust survives seven years.

However, tax can still apply at three points: when the trust is created, every ten years (known as 'periodic' charges), and when assets are distributed to beneficiaries.

Discounted Gift Trusts

With these, you make a gift to the trust but keep the right to receive pre-agreed payments during your lifetime. The gift is valued after applying a 'discount' based on your age, sex, and health, which reduces your taxable estate immediately. However, if you don't spend the payments you receive, they'll be subject to inheritance tax when you die.

Immediate Post-Death Interest Trusts

These give one beneficiary a 'life interest' in the assets, such as the right to live in a house or receive rental income for life. After that beneficiary's death, the assets go to someone else.

For instance, if a husband with children from a previous marriage remarries, he could set up a trust for his second wife to receive income for life, with the capital passing to his children after her death.

In terms of inheritance tax, the trust assets count as part of the life beneficiary's estate when they pass away.

Loan Trusts

In a loan trust, you act as the trustee and make a loan to the trust, often repayable on demand.

The loan is invested, and any growth is immediately exempt from inheritance tax, benefiting the trust and ultimately its beneficiaries.

The best part about trusts is that they can be tailored to your exact wishes.

“Insurance doesn’t reduce the amount of inheritance tax due on an estate, but it is a way to pay a potential inheritance tax bill.”



Insurance to pay IHT

Taking out life insurance to pay inheritance tax

There are two types of insurance policies that can help with inheritance tax: whole-of-life assurance and term insurance.

Whole-of-life policy

With this policy, you agree an amount to be paid out to your beneficiaries after you die. The idea is that your beneficiaries could then use this lump sum to pay the inheritance tax (or a decent sum towards it).

Term policy

This type of policy pays a lump sum if you pass away within a certain time frame. It can be particularly useful if you've made large financial gifts and are worried about not living the full seven years needed to remove them from your estate. The insurance payout could cover the inheritance tax on those gifts, but keep in mind, insurance gets more expensive as you get older, and it often requires a health check which can deter some people.

Most life insurance policies form part of your taxable estate, but if written into trust, the payout will be exempt from inheritance tax. It's always a good idea to seek financial advice to ensure you get the right cover for your needs at the right price.

“If you want to ensure your wishes are followed regarding your assets and possessions after you pass away, you need to create a Will.”



Making a Will

The importance of making a Will

Creating a Will allows you to specify exactly who gets what after you're gone. Your Will can also name legal guardians for your children. You'll appoint one or more people as your executors, who will be responsible for carrying out your wishes after your death. It's important to outline what happens if any of the beneficiaries you've named pass away before you.

Will Writing is not part of the Quilter Financial Planning offering and is offered in our own right. Quilter Financial Planning accept no responsibility for this aspect of our business.

What happens if you don't leave a Will?

If you pass away without a Will, you're considered to have died 'intestate.' Your estate might not be distributed according to your wishes, which can be problematic for unmarried couples or those not in a civil partnership. If you have no close relatives, your assets could end up going to The Crown.

Key Points

- Dying without a Will means you lose control over who inherits your assets; the courts will decide instead.
- Once your Will is created, make sure to review it regularly or after any major life changes, like getting divorced, having children, or moving.
- Keep your Will in a safe place, but ensure it's accessible for someone to find after you pass away.

Make sure you get professional advice to make sure that your Will is legally binding and that your wishes will be carried out.

“Business Relief was designed to ease the burden on families looking to keep their business running smoothly after an owner’s death, ensuring that their hard work could continue without financial strain from inheritance tax.”

Business Relief can be a valuable relief from IHT

What is Business Relief?

Business Relief (BR) was introduced to help small businesses pass down through generations without facing a hefty IHT bill. It allows certain investments (up to the cap of £2.5m) to be passed on to your beneficiaries without being subject to inheritance tax, giving them more of what you've worked hard to build.

Business Relief as an Investment Incentive?

BR is a way to encourage investment in trading businesses, even if you're not directly running one yourself. But it's not just about tax planning - BR is an incentive to invest in companies that are unlisted or listed on the Alternative Investment Market (AIM). While these companies can carry higher risks, the tax relief offered helps offset some of those risks, making BR a valuable option for investors looking for long-term opportunities. Whilst BR investments are totally free of IHT up to £1m, Portfolios invested in the AIM will be fully subject to IHT at a reduced rate of 20%.

Why Hold Shares in BR-Qualifying Companies?

Holding shares in BR-qualifying companies offers a quicker route to IHT relief. Unlike gifts or trusts, which take seven years to become IHT exempt, shares in BR-qualifying investments are exempt/reduced after just two years (as long as they're held at the time of death). Additionally, you maintain control over the investment, meaning you can sell or access the money if needed. It's much simpler than setting up a trust or life insurance, no complicated legal structures or medical underwriting involved.

Investments that Qualify for Business Relief (BR)

Some investment managers can create portfolios that invest in companies qualifying for BR, such as AIM-listed or unquoted companies. By holding these shares for at least 2 years, and until death, they can be passed onto beneficiaries with reduced IHT (AIM) or free from inheritance tax (BR up to £2.5M). For married couples or civil partners, the two-year clock doesn't reset if the investment transfers to the surviving partner. However, it's essential to understand the risks, capital is at risk, tax rules can change, and shares in these companies may be more volatile and harder to sell.

Not all companies qualify, so choosing the right investment manager (we offer this on a referral basis) with experience is vital. Always seek professional advice.

Business Relief and Alternative Investment Market invest in assets that are high risk and can be difficult to sell. The value of the investment and the income from it can fall as well as rise and investors may not get back what they originally invested, even taking into account the tax benefits.

“While ISAs offer great tax benefits during your lifetime, they could present a potential issue for your loved ones when it comes to inheritance tax.”

A reduced inheritance tax ISA

If you've been making the most of your annual ISA allowances, you could have built up a substantial portfolio. However, ISAs are subject to inheritance tax (IHT), and this can have a big impact on the wealth you leave behind.

For instance, a £100,000 ISA could result in a £40,000 IHT bill for your family. The good news is that there are ways to protect your ISAs from inheritance tax while still enjoying the tax benefits during your lifetime. It's essential to include your ISAs in your estate planning to avoid any unnecessary surprises.

A reduced inheritance tax ISA

Since 2013, you've been able to invest in AIM-listed companies within an ISA. If these companies qualify for Business Relief (BR), your ISA can be passed on to your beneficiaries after two years, with a reduced rate of 20% inheritance tax. This is a great way to maintain the tax benefits of an ISA while protecting your loved ones with a reduced inheritance tax bill.

What are the risks?

Alternative Investment Market (AIM) listed shares tend to be more volatile, meaning their value can fluctuate significantly day-to-day.

Investing in an ISA with AIM shares comes with a higher risk profile compared to more traditional equities, bonds, or cash ISAs. Your capital is at risk, and you may get back less than you invest. AIM shares can also be harder to sell, so withdrawals or transfers might not happen immediately or at your preferred price. Additionally, not all AIM-listed companies qualify for Business Relief, and HMRC assesses inheritance tax exemption on a case-by-case basis. Keep in mind, tax rules may change in the future, and benefits depend on your individual circumstances.

**Seeking advice surrounding your investments
is important to ensure the right fit for your
financial situation.**

Watch our video about Inheritance Tax on our YouTube channel:



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channel - don't forget to subscribe!
Thank you for downloading our
Guide to Inheritance Tax.**

There are various investment portfolios that can benefit from inheritance tax relief. This guide provides an overview of these investment types and their associated tax relief. We want to emphasise that this isn't tax or investment advice, and we strongly recommend seeking professional guidance that considers your personal circumstances before making any investment or estate planning decisions.

Investments qualifying for inheritance tax relief come with risks; the value can go up or down, and you might not get back the full amount you invested. The tax benefits will vary based on your individual situation, and tax reliefs can change in the future. Investments in AIM-listed and unquoted companies eligible for tax relief are likely to be more volatile and may be harder to sell compared to shares listed on the main London Stock Exchange. The tax rules outlined in this guide are based on our current understanding of the law and its interpretation as of September 2024.



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