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Strategy and Sustainability

INHERITANCE Tax UK

What inheritance tax is (UK)

Inheritance tax is paid to HM Revenue & Customs (HMRC) when the total value of someone's estate exceeds certain thresholds. It is normally paid by the estate, not directly by the people who inherit.

How much is inheritance tax?

In the UK:

- Standard IHT rate: 40%
- Applied only to the portion of the estate above the tax-free threshold

Tax-free thresholds

1. Nil-rate band:
   - £325,000 (no IHT on this amount)
2. Residence nil-rate band (RNRB):
   - Up to £175,000 extra
   - Applies when a main home is left to children or grandchildren

This means a person may pass on **up to £500,000 tax-free**, or **up to £1 million for a couple** under certain conditions.

When inheritance tax may not be due

Inheritance tax is often **reduced or eliminated** if:

- The estate is **below the threshold**
- Assets are left to a **spouse or civil partner**
- Assets are left to a **UK-registered charity** (can also reduce the tax rate to 36%)
- The deceased gave away assets more than **7 years before death** (with exceptions)

Who pays it and when?

- Paid by the **executor or administrator of the estate**
- Usually must be paid **within 6 months** of the date of death
- Some assets (like property) allow payment in instalments

Why people plan for inheritance tax

Inheritance tax planning can involve:

- Making lifetime gifts
- Trusts
- Pension planning
- Property ownership structuring

This is often relevant for **estate planning and wealth management**, especially for families with property in London where estate values can exceed thresholds quickly.

Transferable nil-rate band (NRB)

How it works

- Everyone has a £325,000 IHT-free allowance.
- Assets left to a spouse or civil partner are 100% IHT-free.
- Because no tax is used on those assets, the first person often uses 0% of their NRB.
- The unused percentage can be transferred to the survivor's estate when they die.

The survivor's estate gets:

- Their own £325,000 plus
- The first partner's £325,000
- Total NRB available: £650,000

Transferable residence nil-rate band (RNRB)

The RNRB is an extra allowance for a **main home** left to children or grandchildren.
Conditions

- Applies only if a qualifying home is left to direct descendants
- Current maximum: £175,000 per person
- Also transferable between spouses/civil partners

Example

- First partner leaves the home to their spouse → uses 0% of RNRB
- On second death, the survivor leaves the home to children

Survivor may claim:

- Their own £175,000 plus
- The transferred £175,000
- Total RNRB: £350,000

Putting both together (common scenario)

Typical married-couple outcome
If:

- Everything passes to the surviving spouse on first death
- Home is later left to children

Then the combined tax-free allowance can be:

Allowance	Amount
NRB (2 × £325k)	£650,000
RNRB (2 × £175k)	£350,000
Total tax-free estate	**£1,000,000**

That's why people often hear that **"a couple can leave up to £1 million tax-free"**.

Simple example in plain English

- Husband dies first, leaves everything to wife
  → No tax, no allowance used
- Wife later dies with:
  - £900k London home
  - £200k savings
- Estate value: £1.1m
  Available allowances: £1m
  Taxable amount: £100k
  IHT due at 40%: £40k

Without the transfer, the tax bill would be much higher.

Transferability

In the UK, **transferability itself is quite robust**—it isn't "broken" easily—but there are **specific situations where some or all of a spouse's unused inheritance tax allowance can be lost or reduced**. Here are the **main things that break or limit transferability**, explained plainly.

Not being married or in a civil partnership

Transferability only applies to spouses or civil partners.

- Cohabiting partners (even long-term)
- Fiancés
- Partners who separated but never married

❌ **No transfer** of unused nil-rate band (NRB) or residence nil-rate band (RNRB).
This is the single most common reason transferability doesn't apply.

Using up the allowance on the first death

You can only transfer the **unused percentage** of allowance.
What reduces it
If, on the first death:

- Assets are left to **children, other family members, or trusts**

- And those gifts exceed the available allowance

➡️ The allowance used **cannot** be transferred later.

Example

- First estate worth £400k
- £325k allowance
- £75k taxable → allowance partly used

✅ Only the **unused percentage** transfers
❌ Not the full £325

Trusts created on first death (common pitfall)

Certain trusts **consume the allowance** on the first death.

Typical examples

- Discretionary trusts
- Life interest trusts (depending on structure)
- Nil-rate band trusts (popular historically)

If a trust **uses up the NRB**, that portion is **not transferable**.

Many older wills unintentionally reduce transferability because they were drafted before spousal transfer became standard

Residence nil-rate band (RNRB) specific traps

RNRB has stricter rules than the standard allowance.

It is lost or reduced if:

- No qualifying residential property exists
- The home is not left to direct descendants
- The estate exceeds £2 million (tapering applies)

➡️ Even if NRB transfers fully, RNRB may not

Downsizing without meeting replacement rules

If the family home was:

- Sold
- Downsized
- Or given away

Then RNRB only survives if HMRC's downsizing rules are met.

If not: ❌ The RNRB (and therefore the transferable RNRB) can be lost.

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Missing or incorrect HMRC claim

Transferability is not automatic.

Executors must:

- Claim the unused allowance when the second spouse dies
- Provide details of the first estate

If:

- Records are missing
- The claim is incorrect or incomplete

➡️ HMRC may refuse or restrict the transfer.

Quick summary table

Situation	Transferability impact
Married / civil partner	✅ Allowed
Unmarried partner	❌ Not allowed
Assets to spouse	✅ Preserved
Assets to others	⚠️ Reduced
Trusts on first death	⚠️ Often reduced
Estate over £2m	⚠️ RNRB tapered
Divorce	❌ Lost
Missing HMRC claim	❌ At risk

Transferability depends on how much allowance is *used* on the first death.

Trusts matter because **some trusts "use up" the allowance immediately**, while others are treated as if the assets passed to the spouse and **preserve the allowance for transfer**.

1.Trusts that preserve transferability

These are trusts where HMRC treats the assets as **effectively passing to the surviving spouse**.

Immediate Post-Death Interest (IPDI) trusts
(often called **life interest trusts for spouse**)

- Surviving spouse has a **right to income or use**
- Trust assets remain in trust but are treated as the spouse's
- **Spouse exemption applies**

✅ **No NRB is used**
✅ **No RNRB is used**
✅ **100% remains transferable**
📌 Common modern use:

- Protect assets for children
- Still keep full IHT efficiency

2.Trusts that break or reduce transferability

These trusts are treated as **gifts away from the spouse**, even if the spouse may benefit later.

Discretionary trusts (most common issue)

- Trustees decide who benefits
- Spouse may be included—but has no automatic right

❌ **Uses the nil-rate band immediately**
❌ Reduces or eliminates transferable NRB
❌ RNRB usually **lost entirely**

Nil-rate band trusts (legacy problem)

Popular in older wills (pre-2007).

- Typically diverted £325k into trust on first death
- Designed *before* spousal transfer existed

❌ Uses the NRB on first death
❌ Leaves **nothing to transfer later**
📌 This is one of the most common reasons couples miss out on the £1m allowance.

3.Partial use = partial transfer

Transfer works on **percentages used**, not headlines.

Example

- 50% of NRB used by trust on first death
  ✅ Only 50% transfers to survivor
  ❌ Other half is permanently lost

This often happens unintentionally.

4.Residence nil-rate band (RNRB): trusts are stricter

RNRB is **far less trust-friendly**.

RNRB is lost if:

- The home goes into a discretionary trust
- The home is not "closely inherited" by direct descendants
- The spouse does not have a qualifying interest

➡️ Even if NRB transfers, **RNRB often doesn't**
✅ Some IPDI trusts can preserve RNRB
❌ Most discretionary trusts cannot

5.What this means in practice (typical scenarios)

Scenario A – Modern, well-structured will

- Everything to spouse via IPDI trust
- Home later left to children

✅ Full NRB transfers
✅ Full RNRB transfers
✅ Up to £1m tax-free

Scenario B – Old will with discretionary trust

- £325k trust on first death
- Rest to spouse

❌ NRB fully used
❌ No NRB transfer
❌ RNRB likely lost
➡️ Large tax bill on second death

6.Why HMRC treats trusts this way

HMRC looks at **who benefits immediately at death**, not intentions or family context.
If:

- The spouse has an **automatic entitlement** → treated as spouse
- The spouse is only a **possible beneficiary** → treated as non-spouse

That's the decisive factor.

Quick summary table

Trust type	Uses NRB on first death?	Transferable?
Spousal IPDI / life interest trust	❌ No	✅ Yes
Discretionary trust	✅ Yes	❌ Reduced / lost
Nil-rate band trust	✅ Yes	❌ Lost
Trust + spouse has no automatic rights	✅ Yes	❌ Lost

Why this matters

Many UK couples—especially homeowners—have:

- Wills written **before transferability existed**
- Trust clauses added "just in case"
- No idea these clauses now **increase tax**

A trust can still be the right solution—but **the *type* of trust matters more than the existence of one**.

Inheritance Tax Planning

1. Use full spouse or civil partner transferability

This is the foundation of almost all UK IHT planning.
What to do

- Leave assets to your spouse/civil partner on first death (outright or via a spousal life-interest/IPDI trust)
- Avoid structures that consume allowances early (e.g. discretionary or nil-rate band trusts, unless deliberate)

Why it matters

- Preserves 100% of both allowances for the second death:
    - £325,000 × 2 (NRB)

    - £175,000 × 2 (RNRB, if conditions met)
- Unlocks up to £1 million tax-free for a couple

2. Make sure your home qualifies

RNRB is often the difference between a large tax bill and none at all.

Key conditions

- You own a qualifying residential property
- It's "closely inherited" by **children or grandchildren**
- Your total estate is below **£2 million** (or mitigated)

Common actions

- Ensure wills pass the home to direct descendants (or via qualifying life-interest trusts)
- Avoid discretionary trusts for the home unless you accept losing RNRB
- If downsizing or selling, ensure **downsizing provisions** are met

3. Make lifetime gifts strategically

Gifting is one of the most powerful tools if done early and consistently.

What works best

- **Potentially Exempt Transfers (PETs)**: survive 7 years → completely outside IHT
- Regular gifts from **normal income**
- Using **annual exemptions** (£3,000 per year, plus small-gift allowances)

Why this helps

- Shrinks the estate
- Preserves full allowances for remaining assets
- Particularly effective for surplus cash/investments

4. Use pensions as a wealth-transfer vehicle

In many cases, defined-contribution pensions are **outside the IHT estate**.

Planning logic

- Spend non-pension assets first
- Leave pensions to beneficiaries
- Keep beneficiary nominations up to date

This can dramatically increase the value passed on tax-efficiently.

5. Use trusts only where they add value

Trusts are **not inherently good or bad**—it depends on structure and purpose.

Trusts that preserve allowances

- Spousal **IPDI / life-interest trusts**

Trusts that usually reduce allowances

- Discretionary trusts
- Nil-rate band trusts (often historic)

Good reasons to still use trusts

- Asset protection
- Control over timing
- Blended families

- Vulnerable beneficiaries

But the **tax cost must be intentional**, not accidental.

6. Plan if your estate may exceed £2m

If your estate goes over £2m, RNRB is reduced by £1 for every £2 over.

Mitigation strategies

- Lifetime gifting
- Charitable legacies
- Trusts (carefully chosen)
- Life assurance written in trust (to fund the tax)

This is especially relevant for London property owners.

7. Use charities to reduce the tax rate

- Leaving **10%+ of the net estate to charity** reduces IHT from 40% to **36%**
- This can sometimes **increase what family members receive**, not reduce it

8. Review wills and records regularly

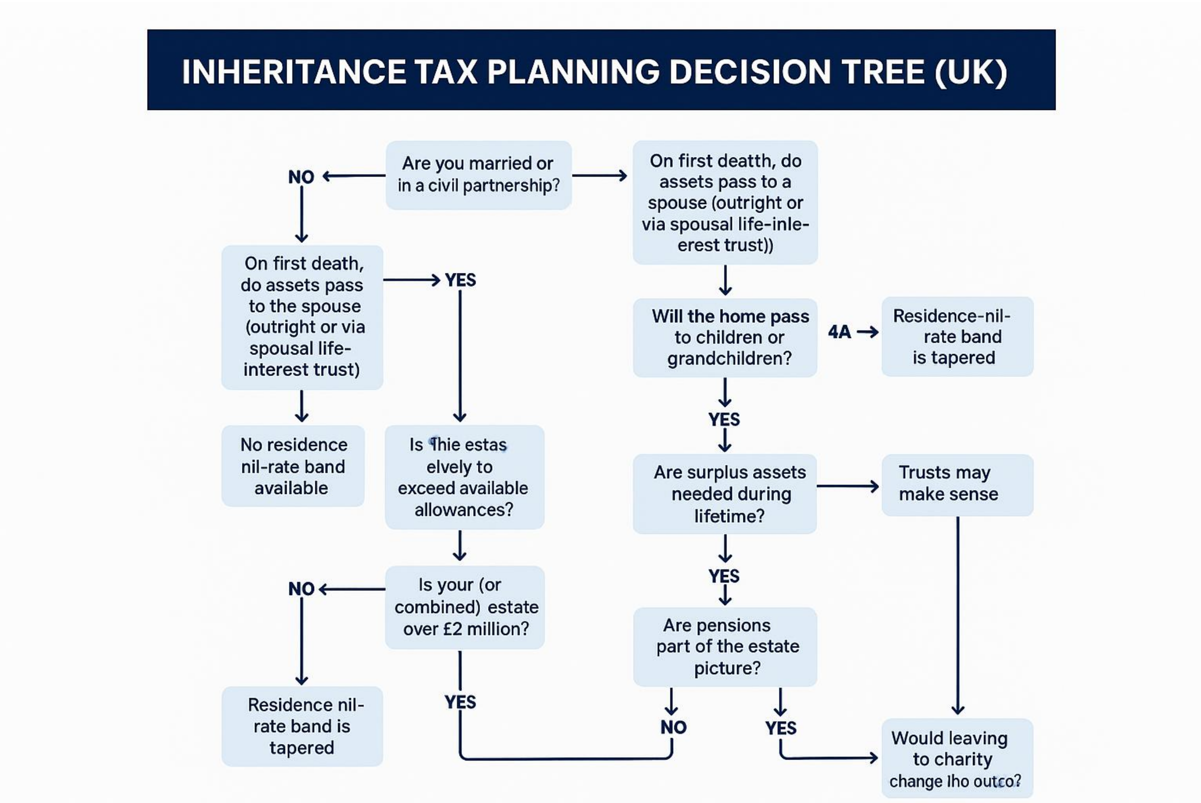
Many IHT problems come from **perfectly legal but outdated documents**.

Check for

- Old nil-rate band trust clauses
- Discretionary trust defaults
- Assumptions made pre-2007 (before transferability)
- Missing records for first-death estates (needed to claim transfer)

A simple prioritised checklist

- Preserve **full spouse transferability**
- Secure **RNRB eligibility**
- Gift surplus assets early
- Use pensions intentionally
- Avoid allowance-burning trusts unless justified
- Plan if approaching £2m estate value
- Align wills with modern tax rules


INHERITANCE TAX PLANNING DECISION TREE (UK)
Are you married or in a civil partnership?
NO
On first death, do assets pass to a spouse (outright or via spousal life-inle-erest trust))
On first death, do assets pass to the spouse (outright or via spousal life-interest trust)
YES
Will the home pass to children or grandchildren?
4A
Residence-nil-rate band is tapered
YES
No residence nil-rate band available
Is Thie estas elvely to exceed available allowances?
Are surplus assets needed during lifetime?
Trusts may make sense
NO
Is your (or combined) estate over £2 million?
YES
Are pensions part of the estate picture?
Residence nil-rate band is tapered
YES
NO
YES
Would leaving to charity change lho outco?

End.