

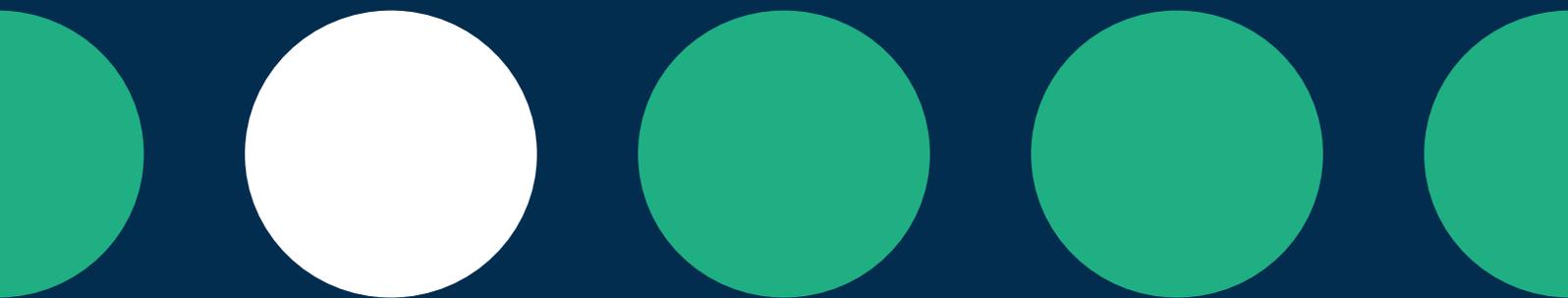
Vouchedfor EXPLAINS...

Inheritance tax

2025

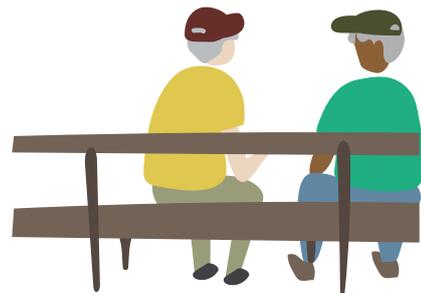
Who pays inheritance tax
and how you can prepare

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Introduction

The standard rate of inheritance tax is 40%. That's a big chunk to come out of what you can pass on. Fortunately, there are allowances and tax reliefs that can soften the blow.

This short guide looks at how to approach the inheritance tax question, what the tax is calculated on, and how much wealth you need to have before it becomes an issue. We also share some common planning strategies that can reduce the amount owed, as well as some mistakes to avoid.

Do I need to plan for inheritance tax?

The first step is to work out how much (if any) inheritance tax would be due now, based on the current value of your estate and any available allowances and reliefs.

Once you know this, consider how you feel about it. Some people are comfortable paying the tax, especially if they have no children. Others are philosophically in favour of paying some tax.

Consider your age, your health, and whether you have a partner. If you have an inheritance tax liability now but you're middle aged, married, and in good health, this isn't necessarily something you have to take urgent action on.

For a couple who are married or in a civil partnership and plan on leaving their wealth to each other, you need to consider your total estate, but the tax on that won't be due until the second person dies.

As the years go by and your remaining life expectancy reduces, inheritance tax planning will probably become more of a priority.



What is inheritance tax based on?

Inheritance tax is calculated based on the value of your estate - what you own when you die.

Your estate includes things like:

 The total value of cash, investments, and other possessions you have when you die.

 The value of your home.

 Any gifts you make to other people in the 7 years before you die. There are some gift exemptions, including the £3,000 annual gift allowance. See the section on lifetime trusts and gifts later in this guide.

 From 2027, it is also likely to include the value of your pension pot.

Your will should name one or more people as your executor(s). People typically choose someone they know (e.g. a close family member or a friend) or a professional (e.g. a solicitor or an accountant). Your executor will be responsible for paying any inheritance tax due from your estate when you die and for distributing the remainder of your estate to your beneficiaries. The tax payment must be settled within six months and is funded from your estate.

If you do not yet have a will, so have not declared who you would like your assets to pass to, then this is a good first step in your inheritance planning. Otherwise, when you die, inheritance law will determine who gets your assets.

Do I pay inheritance tax on everything?

Currently, each person receives an allowance, called the nil-rate band, of £325,000 per individual.¹

Unless your estate is worth more than this allowance, you will not pay any inheritance tax. Any unused part of this allowance can be passed on to a spouse or civil partner when you die, who can then use it in addition to their own.

In addition, there is an allowance of £175,000 per individual, known as the residence nil-rate band, that applies to the value of your home if you are passing it on to a direct descendant (e.g. children, grandchildren or their spouses).

This allowance can also be passed on to your spouse or civil partner if it is not used.

Note that these allowances are per individual. Someone whose partner died without using them could potentially leave an estate worth up to £1 million without any inheritance tax being due, assuming they are leaving their home to a direct descendant.

This is because their allowances would be:

$$\begin{array}{r} 2 \times \text{£}325,000 + \\ 2 \times \text{£}175,000 \\ \hline = \text{£}650,000 + \\ \text{£}350,000 \\ \hline = \text{£}1 \text{ million}^2 \end{array}$$

It is the value of your estate in excess of these allowances that could be subject to inheritance tax.

¹ 2024/25 tax year

² Note that for estates worth more than £2 million, some allowances are lost.

What if I own my home?

For many people, their home will be the most valuable asset they own. They could even have nothing else to their name and there would still be inheritance tax due when they die, simply because of how much their home is worth.

People often think about giving their home away to their children, reasoning that this would mean they have fewer assets when they die and there might be no inheritance tax to pay. However, a gift is only really a gift if there are no strings attached. If you give your house to your children but continue to live in it, that isn't considered a true gift – unless you pay market rent to stay there.

You should also think very carefully about giving your home away, because not owning your own home could put you in a vulnerable position should your circumstances change.

One option to consider, especially in much later life, is taking a lifetime mortgage against your home, also called 'equity release'. You can then use that money to have some memorable experiences, make generous gifts to family, support charities, or pay for care.

All of these reduce the value of your estate, subject to the seven-year gifting rule being met, and so reduce the inheritance tax due when you die.



Common strategies to manage inheritance tax

Strategy	Advantage	Trade-off
Reduce your wealth by enjoying it.	You can turn your wealth into enjoyable experiences.	You need to make sure you can afford it and don't leave yourself short in the future.
Make gifts during your lifetime.	If you live another seven years there will be no inheritance tax due on what you've gifted.	You can't ask for that money back, and you need to make sure you can afford to give that money away.
Leave 10% or more of your wealth to charity when you die.	This reduces the inheritance tax rate from 40% to 36%.	You still pay some inheritance tax and this reduces the amount you can leave to your family.
Move wealth into trusts.	You can keep some control over your assets, while reducing the inheritance tax bill.	There are limits to what is sensible to put into a trust, and you can't usually take it back out again, so you need to make sure you can afford to lock that money away.
Make investments that are eligible for Business Relief.	You retain control of the assets, which help manage your inheritance tax liability and could benefit from investment growth.	These investments are considered high risk, so they could lose money.
Take out life insurance.	This doesn't reduce the inheritance tax owed, but it does provide the money to pay for it.	You have to pay the life insurance premiums, which go up with age and may rely on passing a medical.

How did the 2024 Autumn Budget change things?

The 2024 Autumn Budget introduced a number of changes around inheritance tax in the first significant changes to the tax for some time.

From 6 April 2027, most pension pots are likely to be included in your estate for the purposes of inheritance tax when you pass away. This means that significantly more people can expect to pay inheritance tax.

There were also changes to Agricultural Property Relief and Business Property Relief. A financial adviser can talk you through these changes and how, if at all, they affect your inheritance tax planning.



How do lifetime trusts and gifts work?

Giving money to family or putting it into a trust moves it out of your hands, protecting it from inheritance tax when you die, provided you live for at least seven years after making those gifts.

Trusts are useful because you can control what happens to the money in a trust during your lifetime, and also set out rules or wishes about what you want to happen to it when you've died.

There are also some small gift exemptions, including:

£3,000 annual allowance

£250 small gift allowance

Gifts for weddings or civil partnerships

Regular gifts out of income

Inheritance tax does not apply to these kinds of gifts, even if you die within seven years.

A financial adviser can tell you more about how any gifts you make affect your inheritance tax liability.



Common mistakes and how to avoid them

A common mistake people make is thinking they can pass wealth to their partner free of inheritance tax when they die, without being in a marriage or civil partnership. That's not the case, unfortunately.

Another mistake is thinking you need to do something about it urgently. Tax planning should be proportionate, with a strategy that adapts as the years go by.

If you already have an inheritance tax liability but you are young and in good health, this will be something you need to be aware of but not necessarily take significant steps to eliminate, because the compromises involved in minimising or eliminating the tax liability are significant, particularly at a younger age.

Finally, some people worry about inheritance tax when they are miles away from the thresholds, so there will be nothing to pay when they die.

Use a free inheritance tax calculator - such as www.ihtcalculator.com - with a financial adviser to work out if you do have an inheritance tax liability.

What next steps can I take?

If you think you could have an inheritance tax liability you need to plan for, it makes sense to speak to a financial adviser.

[You can find one near you here.](#)

This content was produced by VouchedFor, home to the UK's most trusted advisers.

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