Inheritance Tax explained

The thresholds, the family home and why £1 million is not a universal exemption.

A tax on the estate and some lifetime transfers

Inheritance Tax (IHT) is generally charged on the net estate after deductible liabilities, exemptions and reliefs. Lifetime gifts may also matter. Assets can include a home, investments, cash, business interests and certain trust or insurance interests. Assets held jointly are not automatically outside IHT. The standard rate is **40%** on the taxable amount. [1]

2026/27 figure	How it works
Nil-rate band (NRB)	£325,000; lifetime chargeable gifts may use it first
Residence nil-rate band (RNRB)	Up to £175,000 for an eligible home passing on death to direct descendants
Estate taper threshold	RNRB reduces £1 for each £2 by which the relevant net estate exceeds £2 million
Possible individual total	Up to £500,000 where all conditions are met
Possible surviving spouse/civil partner total	Up to £1 million with full transferable bands and qualifying home conditions
Charitable legacy rate	36% may apply to a qualifying component where the statutory 10% test is met

The residence allowance has conditions

It is limited by the value of the qualifying residential interest inherited by direct descendants. Children, grandchildren and certain step/adopted/foster relationships can qualify; leaving a home to a sibling or unmarried partner does not normally do so. A former home sold on or after 8 July 2015 may support a downsizing addition, subject to rules. Some trust arrangements prevent qualification. A buy-to-let never occupied as a residence does not automatically qualify. [3,4]

Spouses and civil partners are different from cohabitants

Transfers between spouses/civil partners are generally exempt, subject to cross-border residence restrictions. Unused percentages of the NRB and RNRB may be transferred to a surviving spouse/civil partner. A long-term unmarried partner does not receive the same spouse exemption or transferable bands merely by living together. Wills and ownership arrangements matter. [1,3]

Residence now matters for overseas assets

Since 6 April 2025, the scope for overseas assets generally uses long-term UK residence rules rather than the old domicile test. Broadly, residence in at least 10 of the previous 20 tax years can bring worldwide assets into scope; a tail can continue after departure. Cross-border couples and trusts need specialist analysis. [11]

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Giving money during your life

Exempt gifts, seven-year gifts and the records your executors will need.

Gift route	Main condition
Annual exemption	£3,000 total per donor per tax year; unused exemption can normally be carried forward for one year only
Small gifts	Up to £250 per recipient per tax year; cannot combine with another exemption for that same recipient
Wedding/civil partnership gift	Up to £5,000 to a child; £2,500 to a grandchild/great-grandchild; £1,000 to others, subject to conditions
Normal expenditure out of income	No fixed money cap if the statutory conditions are met
Outright gifts to individuals	Usually potentially exempt transfers: normally outside IHT after seven years if no retained benefit

Gifts out of income: three conditions

The gift must form part of your **normal expenditure**, be made **out of income**, and leave sufficient income to maintain your **usual standard of living**. An established pattern or clear commitment helps evidence normality. Do not treat a single large capital gift as qualifying simply because you have a high income. Keep net income, ordinary spending, gifts and evidence of intention for each tax year. [5,7]

Worked example: regular surplus-income gifts

Maya receives £72,000 a year after tax from pensions and dividends. Her usual spending is £48,000, leaving £24,000 surplus. She commits to giving £1,500 a month to her daughter: **£18,000 a year**. Income still exceeds spending plus gifts by £6,000. If the normal-expenditure conditions and evidence are satisfied, all £18,000 can be immediately exempt; she need not survive seven years for this exemption. Affordability should be reviewed as income and costs change. [5,7]

Capital withdrawals are not automatically income

An ISA withdrawal, an investment sale or a withdrawal from an investment bond may be capital even if it funds monthly spending or creates an Income Tax charge. The IHT meaning of income is its own test. For example, the bond 5% withdrawal facility does not turn capital into qualifying surplus income. Pension lump sums and accumulated income require careful analysis. [7]

Make the records usable

Keep a dated gift schedule showing donor, recipient, amount, purpose, exemption claimed and bank evidence. Explain recurring gifts in writing. Retain annual income/spending summaries and make executors aware of them. Lifetime gifts can also create CGT on assets other than cash; an IHT exemption does not automatically remove other taxes. [5,6]

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The seven-year rule in figures

Taper relief reduces tax on a taxable gift, not the gift itself.

Order matters

Non-exempt outright gifts to individuals are usually potentially exempt transfers (PETs). If the donor dies within seven years, they are normally brought back into the IHT calculation and use the NRB before the death estate. The RNRB does not shelter lifetime gifts. Earlier chargeable transfers and trust gifts can complicate the calculation, sometimes requiring a longer history. [5,6,13]

Time between gift and death	Effective rate on the taxable gift*
Less than 3 years	40%
3 to under 4 years	32%
4 to under 5 years	24%
5 to under 6 years	16%
6 to under 7 years	8%
7 years or more	Normally no IHT on the PET

Worked example: £400,000 gift and death 4½ years later

Assume this is the donor's only chargeable gift, annual exemptions have already been used and the NRB is £325,000. The gift exceeds that band by **£75,000**. At 4½ years, tax on the excess is £75,000 × 24% = **£18,000**, normally payable by the recipient. The gift has used all the NRB, leaving none of that basic band for the death estate. Taper relief does not restore it. [5,6]

A gift below the NRB may still affect the estate

If the same donor instead gave £200,000 and died 4½ years later, that gift could use £200,000 of the NRB without itself bearing tax. Taper relief would not give a percentage discount on the £200,000, because there is no tax on the gift to reduce. The remaining basic band would normally be £125,000 before other transfers. [6]

Keep the benefit and the gift may fail

Giving away your home while continuing to occupy it rent-free is commonly a gift with reservation of benefit. Seven years passing alone does not solve that problem. Market rent and genuine arrangements can change the analysis, but may create other tax and practical consequences. Do not transfer a home or settle it into a trust without legal and tax advice. Care-fee deprivation rules are separate from IHT and have no simple seven-year safe harbour. [8,13,15]

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Estate planning in practice

Use the allowances without overlooking control, security or future changes.

Worked example: a qualifying £1.2 million estate

A surviving civil partner dies in 2026/27 leaving a £600,000 qualifying home and £600,000 other assets to children. Assume no debts or lifetime gifts, full unused NRB/RNRB transferred from the first death and no reliefs. Available bands: £650,000 + £350,000 = **£1 million**. Taxable estate: £200,000. IHT at 40%: **£80,000**. The £1 million outcome depends on the family, home and transfer conditions. [1-4]

The £2 million taper can remove the home allowance

For a single person with a £2.2 million relevant net estate, the RNRB reduction is (£2.2m - £2m) / 2 = £100,000. The £175,000 allowance falls to **£75,000** before other restrictions. At £2.35 million it is fully lost. The estate value for this taper is generally measured before exemptions such as spouse/charity exemptions and before business/agricultural reliefs. [3,4]

Business assets, trusts and insurance

For deaths from 6 April 2026, a combined **£2.5 million** allowance can give 100% Agricultural/Business Relief on qualifying property, with 50% relief above it and transfer rules for spouses/civil partners. Certain shares traded on markets such as AIM qualify only for 50% Business Relief under the new rules, if eligible. Eligibility and ownership conditions apply. [9,10]

A discretionary trust is not a universal tax-free home for wealth: lifetime entry, ten-year and exit charges can arise. Insurance written under an appropriate trust may help fund an IHT bill but does not itself reduce the taxable estate being insured. Review legal ownership, beneficiaries, cost and ongoing affordability. [13]

Pensions: distinguish today from April 2027

Most discretionary unused pension funds are generally outside IHT under the current 2026/27 framework, subject to exceptions. **From 6 April 2027, most unused pension funds and pension death benefits are due to enter the IHT estate.** Do not assume pension wealth remains permanently exempt, or rush withdrawals without considering Income Tax, gifting and retirement security. [12]

Before acting

IHT is normally due by the end of the sixth month after death. Check instalment options. [14]

Primary sources | Checked 24 November 2026

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