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Inheritance tax: Autumn Budget update

In the Autumn Budget, chancellor Rachel Reeves revealed that the inheritance tax-free threshold will remain frozen at its current level until 2030.

She also announced changes to the way pensions are taxed on death, which will have an inheritance tax (IHT) impact for some investors.

By planning ahead, it may be possible to reduce the amount of IHT owed, enabling you to pass on more wealth to your loved ones.

Below, we explain how IHT works and some of the ways you can manage your IHT bill with the help of your adviser.

What is inheritance tax?

Inheritance tax is a tax on the estate (the property, money and possessions) of someone who has died. The standard rate of IHT is 40%.

IHT is only charged on the portion of your estate that exceeds the inheritance tax-free threshold (see below).

IHT isn't payable on assets left to your spouse or civil partner.

What is the inheritance tax-free threshold?

The inheritance tax-free threshold – or 'nil-rate band' – is the amount you can pass on to your beneficiaries free from IHT when you die. It is currently £325,000.

There is an additional allowance for those who pass on their home to their children or grandchildren. This is called the 'residence nil-rate band'. It is currently £175,000, which means an individual's overall tax-free threshold could be as much as £500,000.

If you're married or in a civil partnership, any unused part of your nil-rate band and your residence nil-rate band can be transferred to your partner when you die[1]. This means that when the surviving spouse subsequently dies, they could potentially pass on up to £1 million free from IHT (2 x £325,000 + 2 x £175,000).

For those with very large estates, the residence nil-rate band is tapered. It reduces by £1 for every £2 that your estate exceeds £2 million.

Who pays inheritance tax and when?

IHT is typically paid by the executor of your will or the administrator of your estate. It can be paid for with money from the estate, from the sale of assets, or with any money that has been left to cover the bill.

IHT must be paid within six months from the end of the month in which the person died. If it isn't paid by then, HMRC will start charging interest.

1 This transfer doesn't happen automatically. It needs to be claimed by the estate's executor or administrator within two years from the end of the month in which the second death occurs. For more information see HMRC Form IHT402.

How to potentially reduce your IHT bill

There are several methods your adviser may suggest to potentially reduce your estate's IHT bill. Some of the things to consider include:

Lifetime gifts

Giving away assets during your lifetime can reduce the value of your estate and, consequently, the IHT due. Gifts that may be exempt from IHT include:

- Gifts of up to £3,000 each tax year – this is known as your 'annual exemption'. You can carry forward any unused annual exemption by one tax year.
- Gifts for weddings and civil partnerships – each tax year you can give up to £5,000 to your child, £2,500 to your grandchild or great-grandchild, or £1,000 to any other person.
- Small gifts of up to £250 per person per tax year (as long as you haven't used up another allowance on the same person).
- Regular gifts out of income – if you have surplus income, you can make regular gifts out of this income without them being subject to IHT. There are certain conditions that need to be met to qualify for this exemption. For example, the gifts must be part of your normal expenditure and not affect your standard of living. We suggest speaking to a financial adviser before going ahead.

You can make larger financial gifts – known as 'potentially exempt transfers' – but they are only exempt from IHT if you live for at least seven years after making the gift. Gifts made in the seven years before you die will be added to the value of your estate. And if you give away more than £325,000, anyone who receives a gift above this threshold will have to pay IHT. The rate of tax will depend on the number of years between the date of the gift and your death. Gifts made in the three years before your death will be taxed at 40%, while gifts made between three and seven years before your death will be taxed on a sliding scale. This is known as 'taper relief'[2].

It's important to keep a record of any gifts you make, including the dates, amounts and recipients. This will help the executor of your estate work out any potential IHT liabilities.

Charitable donations

Gifts to charities are exempt from IHT. Additionally, if you leave at least 10% of your estate to charity, the IHT rate on the rest of your estate is reduced from 40% to 36%.

Trusts

Placing assets in a trust can help to reduce your estate's IHT bill. Trusts can be complex and expensive to administer, so it's important to seek advice.

Life insurance

Taking out a life insurance policy to cover a potential IHT bill can ensure your beneficiaries receive the full value of your estate. The policy should be written in trust to ensure the payout is not included in your estate.

2 For more information on taper relief see HMRC's website.

Recent changes to pensions and IHT

In the recent Autumn Budget, it was announced that unused pensions will be subject to IHT from 2027. This is a significant change, as pensions are currently excluded from your estate. There is still some uncertainty around how the new rule will work in practice and it will take some time to get clarity. However, it will mean that if your estate exceeds the inheritance tax-free threshold, any money left in your pension will be subject to 40% tax.

This may be something to consider if you're deciding how to fund your retirement or leave a legacy for the next generation.

It's always a good idea to seek advice when it comes to estate planning and IHT. By planning ahead, you can leave a legacy that supports the next generation and beyond.

Irrespective of the changes announced today, we believe that investors remain well-served by Vanguard's four principles for investing success: have clear and appropriate investment goals; invest in a balanced portfolio of shares and bonds; minimise costs; and maintain perspective and long-term discipline.

Notes: All data in this document are sourced from Autumn Budget, HM Treasury, October 2024 and reflect information available at the time of publication.

Investment risk information

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Please be aware that pension and tax rules may change in the future and the value of investments can go down as well as up, so you might get back less than you invested. You cannot usually access your pension savings or make any withdrawals until the age of 55, rising to the age of 57 in 2028.

Any tax reliefs referred to are those available under current legislation, which may change, and their availability and value will depend on your individual circumstances. If you have questions relating to your specific tax situation, please contact your tax adviser.

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