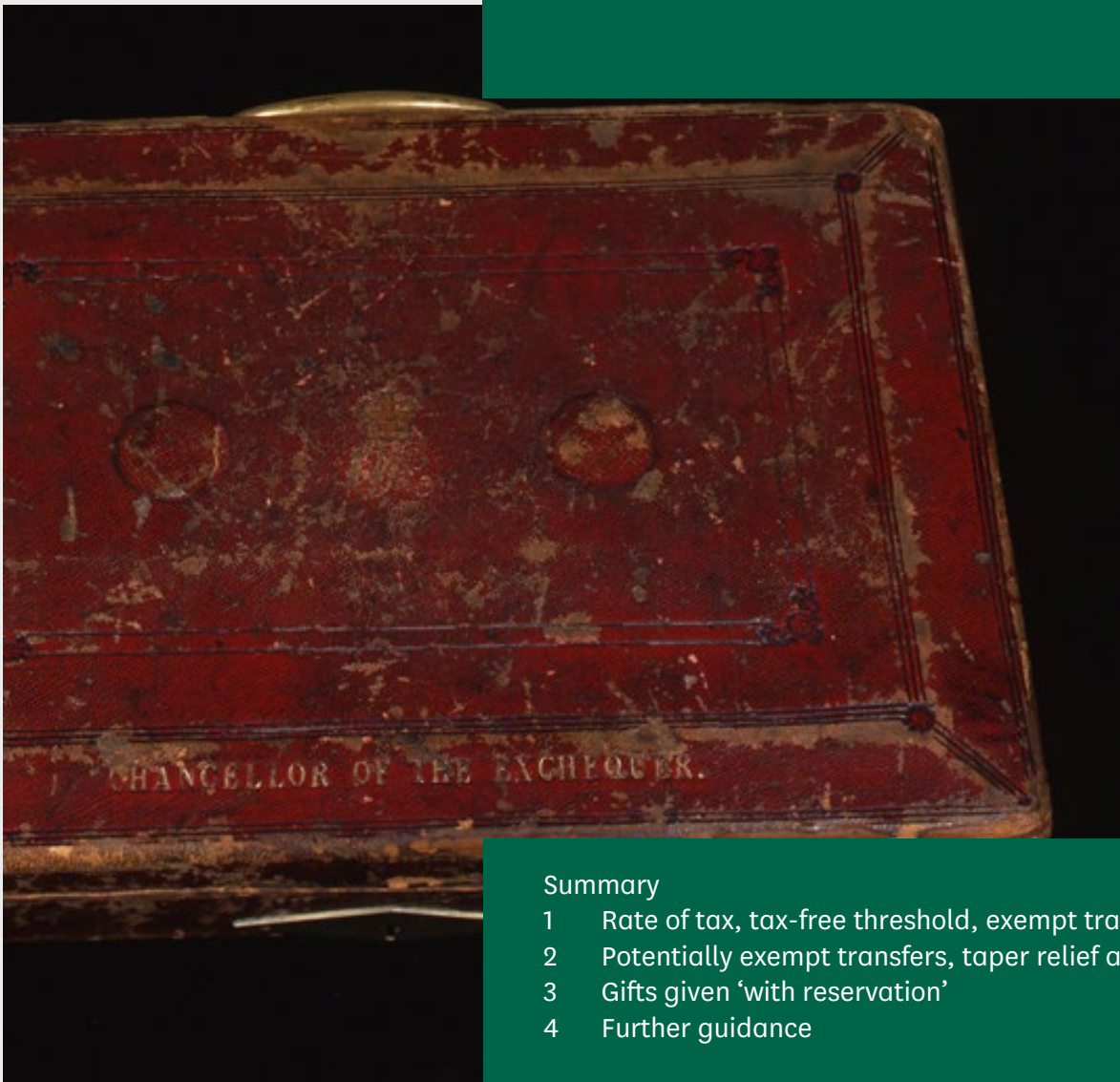


Research Briefing

18 April 2023

By Antony Seely

Inheritance tax : a basic guide



Summary

- 1 Rate of tax, tax-free threshold, exempt transfers
- 2 Potentially exempt transfers, taper relief and other reliefs
- 3 Gifts given 'with reservation'
- 4 Further guidance

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Summary

The rate of tax, tax-free threshold, exempt transfers

Inheritance tax (IHT) is levied on the value of someone's estate when they die. The key primary legislation for IHT is the [Inheritance Tax Act \(IHTA\) 1984](#).

IHT is charged at a flat rate of 40% if the deceased's 'net estate' exceeds a threshold (the nil-rate band, or NRB), set at £325,000 for 2023/24 (it was set at this level in 2009/10). In November 2022, Chancellor Jeremy Hunt announced the NRB would remain at this level until April 2028.

The estates of those who leave at least 10% of their net estate to charity pay a lower 36% rate of IHT.

Certain gifts (given during one's lifetime or made under the terms of a will) are exempt from IHT irrespective of their size. This includes gifts to spouses or civil partners, or to charities.

Other gifts made within seven years of the death may be included in someone's net estate. There are exceptions to this (for instance, a maximum of £3,000 in gifts per year is exempt from calculations of a net estate).

The transferable nil-rate band

From October 2007, people whose spouse or civil partner die without using their full nil-rate band [are transferred the remainder of their NRB](#), which is added onto theirs. For instance, if someone dies without using any of their NRB, their spouse or civil partner's NRB goes from £325,000 to £650,000.

The main residence nil-rate band

From April 2017, those who die and leave their main home to a direct descendant (such as a child or grandchild) have their nil-rate band increased. This also applies if someone has downsized or ceased to own a home after 8 July 2015 (when the measure was announced). The value of this additional NRB was originally set at £100,000 in 2017/18 and increased to £175,000 in 2020/21. The additional NRB is tapered away at a rate of £1 for every £2 if the net estate exceeds £2 million in value. The £2 million taper threshold, and the additional NRB, are frozen at their current value until April 2028.

Potentially exempt transfers, taper relief and other reliefs

Gifts made to individuals that are not outright exempt from IHT may be ‘Potentially Exempt Transfers’ (PETs). This is because gifts become exempt from IHT if the donor lives for at least seven years after the gift was made. If the donor dies in this period, the gift becomes part of the net estate, and may result in a IHT charge if the NRB is exceeded. If IHT is due on a gift, it is the responsibility of the recipient to pay.

If the total value of gifts given in that period exceeds £325,000, gifts given between three and seven years from death are subject to a taper relief, where they are taxed progressively more lightly the further away from death the gift was given.

Two other major reliefs cover business and agricultural property, which in several cases is fully exempt from IHT. Detailed guidance is provided in HM Revenue and Customs’ (HMRC) Inheritance Tax Manual.

Gifts given ‘with reservation’

A gift can be given ‘with reservation’, meaning the donor retains an interest in it. For instance, someone giving their house away but continuing to live in it. In other words, the donor retains some benefit from the gift. These gifts are not counted as PETs, and would be calculated as part of the net estate. Some gifts that are technically with reservation (for example, if a parent gives their house to a child but continues to live in it) would not be counted as such if the donor’s enjoyment of the property arises out of an unforeseen circumstance (for instance, ill health).

Further information and guidance

HMRC publish statistics on IHT including overall liabilities, the composition of estates, and geographical distribution. There is a delay in the data due to the lag between the time of death and when tax is due. The most recent figures are for 2020/21, [published in July 2023](#).

HMRC also publishes [detailed guidance on inheritance tax](#).

Guidance for those dealing with tax following bereavement is published by the [Low Incomes Tax Reform Group \(LITRG\)](#) and by the charity [Tax Help for Older People](#).

This briefing provides a basic overview of how inheritance tax works. A longer Library research briefing on [inheritance tax: Current policy and debates](#) provides a more detailed overview over the development of the tax in the past few years, as well as relevant debates and options for reform.

1 Rate of tax, tax-free threshold, exempt transfers

1.1 The rate of tax and tax-free threshold

Inheritance tax (IHT) is levied on the value of a person's estate at the time of their death. The main provisions relating to this tax are consolidated in the [Inheritance Tax Act \(HTA\) 1984](#).

The tax is charged at 40% above the tax-free threshold, which is £325,000 for 2023/24.¹ In 2021/22 the tax raised £6.1 billion; receipts are forecast to be 7.2 billion in 2023/24.²

It is estimated that the tax was paid on 37,000 estates at death in 2021/22, which represents around 5% of all deaths.³ HM Revenue & Customs [publish statistics](#) relating to the composition of estates, the use of reliefs, the tax due on estates, and geographical data of the number of estates liable to tax on death. These figures are subject to some delay because a six-month lag from date of death to when tax becomes due and subsequent time lags while the data from tax returns is prepared for analysis on HMRC's databases. The most recent figures are for [2019/20](#) published in July 2022.⁴

The tax-free threshold – which is also referred to as the inheritance tax nil-rate band – has been frozen in cash terms at £325,000 since 2009/10.⁵

In the Spring 2021 Budget the then Chancellor Rishi Sunak announced that a number of tax allowances and thresholds would be fixed in value over the four-year period 2022/23 to 2025/26, rather than being increased in line with inflation as is normal practice.⁶ This included the inheritance tax tax-free threshold, so that this remains unchanged for 2023/24.

In November 2022 the Chancellor Jeremy Hunt presented the [Autumn Statement](#), and as part of this the Chancellor announced this freeze in

¹ HM Treasury (HMT), [Overview of Tax Legislation and Rates](#), March 2023 ([Annex A](#))

² Office for Budget Responsibility (OBR), [Economic & Fiscal Outlook, CP804](#), March 2023 ([Table A5](#)). See also, OBR, [Tax by tax, spend by spend: Inheritance tax](#), January 2023.

³ HMRC, [Statistics: Numbers of taxpayers and registered traders](#), April 2022; ONS, [Vital Statistics: Population and Health Reference Tables](#), December 2021 (There were 689,629 deaths registered in the UK in 2020).

⁴ HMRC's inheritance tax statistics are collated [on Gov.uk](#).

⁵ Historical details of the rates of tax and the level of the tax-free threshold are give in, HMRC, [Inheritance Tax and Capital Transfer Tax thresholds and rates](#), July 2015

⁶ [Budget 2021](#), HC 1226, March 2021 para 2.73-76

allowances and thresholds would be extended a further two years.⁷ As a consequence it is anticipated that the tax-free threshold will remain at £325,000 until April 2028.⁸

1.2 Reliefs for gifts

Certain gifts are exempt from tax irrespective of their size, and irrespective of whether they are made during one's life, or made under the terms of one's will.⁹ These are:

- Gifts made to one's spouse or civil partner.
- Gifts made to charities.¹⁰
- Gifts made to political parties.
- Dispositions for the national interest.¹¹

Historically the exemption for gifts made to one's spouse was limited to £55,000, if one's spouse was not 'domiciled' in the UK – that is, broadly speaking, the UK was not their permanent home. Since 2013/14 this has been set equal to the nil rate band, and a non-domiciled spouse or civil partner has the option to be treated as having UK domicile for IHT purposes.¹²

Since 2012/13 an estate may be liable to a lower 36% tax rate, if 10% of the 'net value' of the estate is left to a charity.¹³ The 'net value' of an estate is the total value of all the assets after deducting: debts and liabilities; reliefs; exemptions (eg anything left to a husband, wife or civil partner); and, anything below the tax-free threshold.¹⁴

When calculating the taxable value of a person's estate, transfers made out of someone's estate within seven years of their death are included. There are some gifts which one can make in the last seven years of one's life which do not attract tax. The most important of these are:

⁷ [HC Deb 17 November 2022 c846](#). For more details see, Commons Library briefing CBP9186, [Spring Budget 2021: personal allowance and higher rate threshold](#), 28 March 2023.

⁸ [Autumn Statement 2022](#). CP 751, November 2022 para 5.19; HMRC, [Inheritance Tax nil-rate band and residence nil-rate band thresholds from 6 April 2026](#), 21 November 2022

⁹ For more details see, HMRC, [How Inheritance Tax works: thresholds, rules and allowances: Rules on giving gifts](#), ret'd April 2023

¹⁰ Donations to a foreign charity which is established abroad do not normally qualify.

¹¹ This relief covers gifts to a specified list of bodies including colleges and universities, the National Trust, the National Gallery, the British Museum & other galleries and museums run by local authorities or universities.

¹² Budget 2013, HC 1033, March 2013 para 2.77

¹³ Budget 2012, HC1853, March 2012 para 2.81

¹⁴ HMRC have [an online calculator](#) on the operation of the reduced rate.

- Gifts made as normal expenditure - on a regular basis, such as under a covenant - which come out of one's income.
- Gifts made during the one tax year of a total not exceeding £3,000.¹⁵
- Any number of individual gifts, worth up to £250, made during the year to different persons (this relief is in addition to the annual allowance of £3,000).¹⁶
- Gifts, up to a specified maximum, given to the bride or groom, in consideration of marriage. Parents can each give up to £5,000; grandparents may give £2,500, as may the bride or groom. Anyone else may give £1,000. Parents can make gifts to either party in the marriage; so that, say, a bride's parents could each give £5,000 to their son-in-law. Gifts should be made so that they are conditional upon the marriage taking place.

1.3 The transferable nil-rate band

Widows, widowers and civil partners are entitled to use the share, if any, of their partner's tax-free allowance which was unused when they died, to set against tax on their own estate.

This important relief was introduced by the then Chancellor, Alistair Darling, in his Pre-Budget statement on 9 October 2007.¹⁷ This transferable allowance is available to all survivors of a marriage or civil partnership who die on or after 9 October 2007 – whenever their first partner died.

It is important to underline the fact that this is **not** equivalent to simply doubling the exempt threshold for couples; a press notice issued at the time provided a worked example:

Transfers of property between spouses or civil partners are generally exempt from IHT. This means that someone who dies leaving some or all of their property to their spouse or civil partner may not have fully used up their nil-rate band. The new rules will allow any nil-rate band unused on the first death to be used when the surviving spouse or civil partner dies.

The amount of the nil-rate band potentially available for transfer will be based on the proportion of the nil-rate band that was unused when the first spouse or civil partner died. For example:

On the first death none of the original nil-rate band was used because the entire estate was left to a surviving spouse. Then if the nil-rate band when the

¹⁵ If the full £3,000 is not used in a given year, the balance can be carried forward for one year only – and is then only allowable if the exemption for the second year is fully utilised.

¹⁶ This exemption cannot cover the first £250 of a larger annual gift made to any one person.

¹⁷ [HC Deb 9 October 2007 c174](#)

surviving spouse dies is £350,000 that would be increased by 100 per cent to £700,000.

If on the first death the chargeable estate is £150,000 and the nil-rate band is £300,000, then 50 per cent of the original nil-rate band would be unused. If the nil-rate band when the surviving spouse dies is £350,000, then that would be increased by 50 per cent to £525,000.

The amount of additional nil-rate band that can be accumulated by any one surviving spouse or civil partner will be limited to the value of the nil-rate band in force at the time of their death.

This may be relevant where a person dies having survived more than one spouse or civil partner. This may also be relevant where a person dies having been married to, or the registered civil partner of, someone who had themselves survived one or more spouses or civil partners.¹⁸

If a person's spouse died **before** 1975 – the year that Capital Transfer Tax, the forerunner to IHT, was introduced – the value of the transferable allowance may be limited.¹⁹

HMRC published a list of FAQs on the new allowance when it was first introduced; an extract is reproduced below:

What do you mean by a transferable nil rate band?

A transferable nil rate band arises when one party to a marriage or civil partnership dies and the amount of their estate that is chargeable to IHT does not use up all of the nil rate band they are entitled to. Where this happens, the unused part can now be transferred to the surviving spouse or civil partner when they die.

How does that work then?

Everyone is entitled to a nil rate band for IHT. Assets that pass from one spouse or civil partner to another are exempt from IHT. So if on death, someone leaves everything they own to their spouse or civil partner, it is exempt from IHT and they have not used any part of their nil rate band.

That unused nil rate band can now be transferred to their surviving spouse or civil partner and used in working out the IHT liability on their estate when they die [...]

So you mean that if I inherited all the assets from my spouse or civil partner, my executors could add their nil rate band to the nil rate band that applies when I die?

Essentially yes – but it works by looking at the proportion of the nil rate band that was unused when your spouse or civil partner died and uprating the nil rate band available when you die by that same proportion.

¹⁸ HMRC, [IHT nil-rate band : Pre-Budget Notice PBRN16](#), (PDF), 9 October 2007. Provision to this effect was made by section 10 and schedule 4 of Finance Act 2008.

¹⁹ For guidance see HMRC, Inheritance Tax Manual [para 43060](#) ret'd April 2023.

What do you mean by uprating the nil rate band available by the same proportion?

The amount to be transferred is worked out by taking the proportion of the nil rate band that was unused on the first death and applying that to the nil rate band available when you die. So if your spouse or civil partner left assets worth £150,000 to your children with everything else to you and the nil rate band on their death was £300,000; one-half of their nil rate band is unused and is available for transfer. If, when you die, the nil rate band had increased to £325,000, the amount available for transfer would be 50% of £325,000 or £162,500 giving your estate a nil rate band of £325,000 + £162,500, or £487,500 in total.

What if my spouse or civil partner's estate was only worth £100,000, so that they did not need all of their nil rate band. Is the amount that can be transferred tied to the amount that they actually left to me?

No - it doesn't matter what the size of first estate was, whatever proportion of the nil rate band is unused may be transferred to you. If your spouse or civil partner's estate was worth only £100,000 and they left everything to you, they will not have used any part of their nil rate band. So 100% of the nil rate band is available for transfer when you die [...]

I am divorced and my ex-husband has died without remarrying, can my personal representatives claim to transfer his unused nil rate band to my estate when I die?

No, in order for your personal representatives to be able to make a claim to transfer unused nil rate band, you must have still been married to your husband when he died.²⁰

1.4

The main residence nil-rate band

In his Budget statement on 9 July 2015 the then Chancellor George Osborne announced that from April 2017 an additional nil-rate band would apply on transfers on death of a main residence to a direct descendant.²¹ In this context a direct descendant is “a child (including a step-child, adopted child or foster child) of the deceased and their lineal descendants.” Initially the main residence nil-rate band was set at £100,000.

The main residence nil-rate band is subject to a taper, for any estate with a net value of more than £2m: the band is withdrawn by £1 for every £2 the estate exceeds this threshold by. If someone downsizes or ceases to own a home before they die, the additional band may still be claimed on assets of an equivalent value, if passed on death to direct descendants. This applies if someone downsizes or ceases to own a home on or after 8 July 2015.²²

²⁰ HMRC, [Transferable nil rate bands – FAQs](#). (PDF), 23 October 2007 pp1-2, p9

²¹ [HC Deb 8 July 2015 cc330-1](#); [Summer Budget 2015](#), HC 264, July 2015 paras 1.217-221

²² HMRC, [Inheritance tax: main residence nil-rate band and the existing nil-rate band: tax information & impact note](#), 8 July 2015

In addition, Mr Osborne confirmed that the existing tax-free threshold (also called the nil-rate band) would be frozen at £325,000 at least until 2020/21, while the main residence nil-rate band would rise by £25,000 each year, to reach £175,000 in 2020/21. Prior to this, in 2013 the Coalition Government had proposed that the threshold should be frozen until April 2018.²³ As with the nil-rate band, any unused fraction of the main residence nil-rate band may be transferred to a surviving spouse or civil partner.²⁴

Provision to introduce the main residence nil-rate band from April 2017, and to increase it over 2017/18 to 2020/21, was made by sections 9-10 of the [Finance \(No.2\) Act 2015](#).²⁵

At the time there was some controversy over the Government's decision to restrict the new main residence nil-rate band to transfers to a donor's direct descendant. At the Committee stage of the Finance Bill, when these provisions were scrutinised, Treasury Minister, David Gauke, set out [a number of minor amendments](#), before going on to address this issue:

The Government have tabled six amendments to clause 9. Amendments 1 to 3 clarify that homes placed in some types of trust for the benefit of a surviving spouse during their lifetime, and where the home passes to a direct descendant on the spouse's death, will benefit from the new main residence nil-rate band. Amendments 4 and 5 will ensure that the main residence nil-rate band will apply when an individual leaves their home to the current or surviving spouse or civil partner of anyone already defined as a direct descendant. Finally, amendment 6 is a minor change to the definition of a foster parent to include other similar terms, such as kinship carers in Scotland ...

The Government have sought to focus on the passing of homes to the next generation in the immediate family, which ensures that parents know that they can pass on the family home they worked hard for without the worry of inheritance tax. The extension of that to homes left to others would carry an additional cost to the Exchequer, which would need to be financed by raising other taxes or reducing public expenditure. We sought to strike the appropriate balance, with a policy that allows the family home to pass on to the next generation, but which is also affordable. In terms of the impact on downsizing and the housing market, the OBR agreed that there will be only a small effect.²⁶

As noted, in the Spring 2021 Budget the then Chancellor Rishi Sunak announced the nil-rate band would be frozen until April 2026. In addition both the residence nil-rate band (£175,000), and the start point for the residence nil-rate band taper (£2 million) would be frozen for this period.²⁷ In the 2022 Autumn Statement the Chancellor Jeremy Hunt announced that the nil-rate

²³ [Budget 2013](#), HC1033, March 2013 para 2.76

²⁴ For more details see, HMRC, [Work out and apply the residence nil rate band for Inheritance tax](#), September 2019.

²⁵ Provision with regard to the new nil-rate band where someone has downsized their home is included in Finance Act 2016 (specifically [section 93 and schedule 15](#))

²⁶ [Public Bill Committee \(Finance Bill\)](#), Second Sitting, 17 September 2015 c55, c61; see also, [PQ9086](#), 11 September 2015

²⁷ [Budget 2021](#), HC 1226, March 2021 para 2.73-76

band would be frozen for a further two years, to April 2028. In addition the residence nil-rate band and the residence nil-rate taper would also be frozen until April 2028: at £175,000 and £2 million respectively.²⁸

²⁸ [Autumn Statement 2022](#), CP 751, November 2022 para 5.19; HMRC, [Inheritance Tax nil-rate band and residence nil-rate band thresholds from 6 April 2026](#), 21 November 2022

2

Potentially exempt transfers, taper relief and other reliefs

Other gifts which do not fall under the criteria listed above may be “potentially exempt transfers” (PETs) and, as such, be exempt from tax. Most important, all gifts made to individuals may be PETs.

PETs become exempt from IHT only if the donor lives for **at least** seven years after having made the gift concerned (this is known as the seven year rule). If the individual dies during this seven year period, the PET becomes a chargeable transfer, and its recipient becomes liable to pay the tax charged on it. Of course whether IHT is charged on the gift in practice would depend on the value of the donor’s estate at death, and whether both gift and estate came to less than the zero-rate threshold.

It is important to remember that, when assessing the value of someone’s estate, the tax authorities **include** gifts made by this person in the last seven years of their life. As a consequence, even though someone’s wealth may be less than the nil-rate threshold when they die, their estate may still be liable for IHT, since the inclusion of PETs made in the previous seven years may push it over this threshold. The tax payable on the estate depends on the rates of IHT in force at the date of death. Notably, it is the recipient of the PET who is liable to pay the tax. The operation of this rule can penalise those who wish to pass on assets to family members or other beneficiaries, but have not done so before death intervenes.

There is provision to reduce the tax charge that would be imposed on PETs, if these PETs are made between three and seven years before the donor’s death. Taper relief, as it is called, is only given to mitigate the inheritance tax charge that would be made on gifts made in this period. For this purpose, gifts are considered **before** the rest of the estate. If these gifts fall below the tax-free threshold, they would be tax-free in any case. If so, the estate is not eligible for taper relief at all, even if the total value of the donor’s estate at death - gifts included - is above the tax-free threshold.²⁹

Relief is available as a percentage reduction in the tax payable on the gift itself; the nearer the donor is to surviving seven years after the gift, the greater the relief:

²⁹ The guidance notes which accompany the [IHT account \(IHT400\)](#) gives some details on the way that taper relief works ([Guide to completing your Inheritance Tax account: IHT400 Notes](#) (PDF), September 2022 p77). See also HMRC Inheritance Tax Manual, [paras 14611-13](#), ret’d April 2023.

Years between transfer & death	% reduction in tax payable
0 - 3	0 %
3 - 4	20 %
4 - 5	40 %
5 - 6	60 %
6 - 7	80 %

Two important reliefs cover business and agricultural property, so that the bequest of family businesses and family farms is generally exempt from IHT. Detailed guidance on the operation of both of these reliefs is given in HMRC's Inheritance Tax Manual.³⁰

³⁰ HMRC, Inheritance Tax Manual: business relief and businesses ([from para 25000](#)); and, Inheritance Tax Manual: Agricultural relief ([from para 24000](#)), ret'd April 2023

3

Gifts given ‘with reservation’

In certain circumstances, one may make a gift, and yet retain an interest in it; one example is where a parent gives their house to their child, but continues to live in it as before. This type of gift is called a ‘gift with reservation’, and it is made in the following circumstances:

- The donor of the gift does not really lose possession of it; say, in the case where someone gives away a valuable painting, but insists that it continues to hang in their own house.
- The donor of the gift continues to derive some benefit from the gift; that is, unless they pay a full market rate - or the equivalent in kind - for their use of the asset; eg, when someone gives their house to their children, but they go on living in it rent-free.

A gift ceases to be a gift with reservation (GWR) as soon as the donor cedes any benefits he or she enjoys from it. If they enjoyed it right up until the time of their death, then this gift is treated as being part of the donor’s estate, and given away only at the time of death. If the donor stopped benefiting at some stage before death, then the gift is treated as a PET given at the time when the donor’s benefit stopped: ie, if this happened within seven years of their death, there might well be a tax charge on the gift.³¹

In the case of one’s home, there are ways in which one may continue to live in it, and yet not derive a benefit from it – say, by paying rent, or to offer rent-in-kind (such as one’s services as housekeeper and gardener) equivalent in value to the market rent for the property in question. There is provision for the gift of a house not to be counted as a GWR, if the donor’s enjoyment of the property arises out of an unforeseen change in circumstances, and the donee is either a relation of the donor of the gift, or their spouse.

Someone might give up their house to their children, moving somewhere smaller, but, some years later, find that they were forced by ill health to move back into this house, to be looked after. In such cases it is possible that the ‘reservation’ element of their original gift would be ignored. It is important to note that such a gift would only be treated as a PET if the donor’s change of circumstances - ill health, financial ruin - were unforeseen at the time the gift was made, and were not brought about by the donor to receive this benefit.

Clearly individuals concerned as to whether a particular gift they intend to make is a GWR or not are strongly advised to take professional legal advice –

³¹ Detailed guidance on the GWR rules is given in HMRC’s Inheritance Tax Manual, from [para 14301](#), ret’d April 2023.

as would any individual who expects their estate to be of a considerable size at their death and potentially subject to inheritance tax.

In the Pre-Budget Report in December 2003 the Labour Government announced a change in these rules to prevent “avoidance of the inheritance tax rules for gifts with reservation”: the introduction of a charge on the benefit gained from using the asset in question.³² In the 2004 Budget the Labour Government confirmed that this free-standing income tax charge on ‘pre-owned assets’ would be introduced from April 2005, although the charge “would not affect legitimate transactions between family members.”³³

³² HMT Pre-Budget Report press notice, Tackling tax avoidance, 10 December 2003

³³ Budget 2004, HC 301 March 2004 para 5.88. Provisions to this effect was made under section 84 and schedule 15 of Finance Act 2004. Detailed guidance on this income tax charge is given in HMRC’s [Inheritance Tax Manual](#) (from [para 44000](#), ret’d April 2023).

4 Further guidance

HM Revenue & Customs provide detailed guidance on inheritance tax [online](#).

Guidance for those dealing with taxation following a bereavement is published by the [Low Incomes Tax Reform Group \(LITRG\)](#),³⁴ and by the charity [Tax Help for Older People](#).

Quite often individuals are keen to make contingency plans to mitigate the tax that may be charged on their estate when they die. This is an issue that is often covered in the press,³⁵ and in specialist publications.³⁶

³⁴ see in particular LITRG, [Bereavement and tax](#), 5 April 2023

³⁵ For example, “How to make the most of new inheritance tax rules”, Financial Times, 5 May 2017; “A valuable inheritance”, Taxation, 5 July 2018

³⁶ For example, Carl Bayley, How to Save Inheritance Tax 2022/23, July 2022

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