INSIGHTS

Time for action: succession planning strategies before the IHT relief cliff edge

The Autumn 2024 Budget sent shockwaves through the business and farming communities with the unexpected announcement that Business Relief and Agricultural Relief from inheritance tax (IHT) will be drastically curtailed from April 2026.

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With limited time available under the current regime, families and business owners have a window of opportunity to consider and implement effective succession strategies – including gifting to the next generation or to trusts – to mitigate the risk of a future IHT bill that could force the sale or break-up of the business they've spent a lifetime building.

At a glance: succession planning before the 2026 cliff edge

With the clock ticking toward April 2026, it's never been more important for business owners and farming families to act. The forthcoming changes mean that traditional succession routes could soon attract significant IHT charges, prompting the need for urgent planning.

Below is a high-level summary of the key issues and actions to consider – designed to help families and advisers quickly grasp the essentials before exploring the core succession strategies in more detail.

- **Act now — don't wait:** From 6 April 2026, only the first £1m of qualifying business/farming assets will be fully exempt from IHT. Anything above gets just 50% relief — adding a 20% tax burden.

- **Review succession plans immediately:** The current 12-month window offers a rare opportunity to gift shares or assets tax-efficiently before the rules change.

- **Gifting to the next generation:** A well-worn route, but only IHT-efficient if the donor survives 7 years and the gift qualifies for full reliefs. Consider life insurance to cover risk.

- **Trusts remain powerful — for now:** Until April 2026, unlimited value of qualifying assets can still be settled into trusts without triggering IHT. Post-2026, anything over £1m may attract a 10–20% immediate tax charge.

- **Trading status is crucial:** For CGT holdover relief, businesses must pass the tough "80% trading" test. For IHT, the hurdle is lower at 51% — but fail it, and relief is lost altogether.

- **Watch for investment 'creep':** Passive investments within businesses could quietly tip the balance and restrict or deny relief.

- **Growth shares can 'freeze' value:** A useful tactic to limit future exposure, but won't reduce current IHT liability.

- **Sale on the horizon?:** Gifting shares to a trust before sale can protect proceeds from 40% IHT — but requires careful planning and early action.

- **'Hold until death' still has a role:** For assets within the £1m threshold, retaining until death may still make sense to benefit from the CGT uplift.

- **Every plan is personal:** Success depends on understanding family objectives, business dynamics and timing.

- **Business valuations will become critical:** Accurate professional valuations are essential to assess potential IHT exposure — particularly if using life insurance to fund the liability. The valuation at death forms the basis for IHT, but market conditions or internal changes can reduce the business's value post-death. If the business must be sold to pay the tax, the real-world cost of IHT may significantly exceed 20–40% of proceeds. Early valuation helps avoid unpleasant surprises.

Gifting shares

Under the new rules taking effect from April 2026, only the first £1 million of qualifying business or agricultural assets in an estate will be fully exempt from IHT, provided the relevant conditions are met. Any value above that threshold will receive only 50% relief, resulting in an effective IHT rate of 20% on those excess assets. This marks a significant shift from the current regime and has left many business owners and farmers reassessing their succession plans in the face of a potential tax burden that could impact the long-term viability of family-owned enterprises.

In many cases this new and unexpected exposure to IHT will create a need to raise funds to pay the IHT from external sources or, in some cases, it may force a sale or closure of the business; the precise events these reliefs exist to prevent to ensure business continuity.

FACED WITH THESE CHALLENGES, WHAT CAN BUSINESS OWNERS DO IN ADVANCE TO IMPROVE THE POSITION?

Although the availability of relief needs to be carefully evaluated in each case, the following options may be available:

- Gifting shares to the next generation
- Gifting shares to a trust for future generations

To be IHT efficient both of these strategies require the donor to survive the gift by 7 years and therefore it may not be appropriate in every case and in those where it is, life insurance should also be considered.

Gifting shares to the next generation

When gifting shares or assets, the main taxes to consider are capital gains tax ("CGT") and inheritance tax ("IHT").

Holdover relief from capital gains tax is available for:

- Gifts of shares in a trading company or trading group, and
- Gifts of business assets used in a trading business.

The key aspect when gifting shares or assets is ensuring that full relief is available — otherwise, CGT will be payable on the making of the gift.

HMRC looks critically at whether the qualification criteria for relief are met. In brief:

- At least 80% of the assets, turnover and activity within the business must relate to the trade.
- Certain trades are barred from relief.
- A main risk for well-established businesses is that they may become victims of their own success by using surplus trading profits to make investments, meaning the 80% test is failed.

However, even where the "80% trading" test has been passed, there can still be a CGT liability.

This occurs where even a very small percentage of the asset base is represented by assets which, although income-generating, are not used for trading purposes and are instead passive investments.

A different test applies for IHT purposes to determine whether a company or group is regarded as "trading" and whether it qualifies for Business Relief or Agricultural Relief:

- The relevant test is whether 51% or more of business activity and assets relate to trading rather than investment business.
- Although this is a lower hurdle to clear than for CGT, IHT relief can be restricted for "excepted assets" which do not qualify.

- Relief is not available at all if the overall “51% trading” test is failed, even where a substantial proportion of assets and activity relates to a trade.

There are further IHT complexities with groups of companies where investment assets are held by subsidiaries. In such cases, each subsidiary is considered separately to determine whether it should be treated as an “excepted asset” that does not qualify for relief.

Even in those cases where shares or assets qualify for relief from both CGT and IHT, an additional issue to consider when gifting is that the next generation may face the same challenge of ensuring they don’t incur significant costs when passing the business on to their children.

In other words, gifting assets to the next generation in the case of a business intended to continue for several generations is only a temporary solution.

Gifting shares to a trust

Capital gains tax holdover relief is also available for gifts of shares in a trading company or trading group and for gifts of business assets used in a trading business when the recipient of the gift is a UK trust.

The key difference when gifting shares to a trust is that different legislation applies, and gifts of shares in trading companies still qualify for capital gains tax holdover relief in full, despite the fact that some of the assets of the business may be investments that are unrelated to the trade. This means there is potentially no limit on the value of shares in a trading company or trading group that can be settled on a trust.

For those who are selling their business and will receive more than they need personally, it can make sense before the sale to gift some of the shares in the trading company to a trust from which they are excluded from benefiting.

CGT holdover relief can be claimed on the gift to the trust, and the disposal proceeds of the gifted shares are then protected from a 40% charge on death. However, there will be IHT charges on the trust of up to 6% every 10 years, based on the value of assets held by the trust on each ten-year anniversary of it being established.

For inheritance tax (IHT), the current position is that shares or assets of an unlimited value can be gifted to a trust if they qualify in full for Business Relief or Agricultural Relief.

However, for any assets that don’t qualify in full, there can be an IHT “entry charge” of up to 20%, payable by the donor of the gift to the trust 6 months after it is made.

There is a maximum limit of £325,000 per individual on the value of assets that don’t qualify for Business Relief or Agricultural Relief that can be gifted to a trust without the 20% entry charge applying.

Therefore, care needs to be taken when deciding what can be gifted to a trust.

This route can be particularly attractive where:

- There is a long-term desire to protect wealth for future generations;
- The current owners wish to step back gradually from ownership or management;
- A sale of the business is on the horizon, and the proceeds can be more efficiently held within a trust for future planning.

Ultimately, gifting shares to a trust can offer valuable tax advantages, but only where the correct conditions are met and the right structures are in place.

Other strategies

Previously, the availability of Business Relief encouraged succession planning that involved retaining qualifying assets until death, in order to benefit from the capital gains tax market value uplift on death. Various testamentary strategies have also been employed to make the most of the BPR availability – however, now that the BPR will be restricted, these strategies should be revisited.

Gifting and holding over the gain means that the family would not benefit from the base cost uplift on death, and because a 40% Inheritance Tax exposure is much higher than the current 24% rate of CGT, the "hold until death" strategy may still be worthwhile within the £1m allowance. It may also become more attractive if the rate of CGT is increased to match income tax rates in future, which there continues to be speculation about.

In certain circumstances, crystallising an element of taxable gain in order to 'bank' the 24% rate may be appropriate — particularly where this could allow the retiring generation to extract surplus funds from the business at the same time. However, the pros and cons of such a transaction should be carefully understood.

A further strategy may be to create and gift 'growth shares' that have limited current value initially, but would become more valuable over time.

However, this will only 'freeze' the existing IHT exposure and will not reduce it.

5 April 2026 deadline

Under the current rules, it can be relatively straightforward to use trusts as a succession planning vehicle for trading and farming businesses with no immediate tax costs.

From 6 April 2026, transfers of shares or assets in a trading or farming business to a trust in excess of £1 million may attract an immediate tax charge.

For many, this is simply not enough, and they may decide to gift shares or assets to the next generation, in the hope they will survive for 7 years and the assets will escape IHT at the new effective rate of 20%, due to the restriction to Business Relief and Agricultural Relief.

This pattern of gifting will then have to be repeated for future generations.

In addition to the 7-year IHT risk, the gifted assets will have to pass the "80% trading" test to qualify in full for CGT holdover relief.
Gifting assets to a trust over the £1m limit will result in an immediate IHT "entry charge" of 10% of the value of the assets, because Business Relief and Agricultural Relief will be restricted to 50%.

However, there is a window of opportunity to benefit from the current rules and transfer qualifying shares and assets to a trust at potentially zero tax cost by 5 April 2026.

In some cases, this will require a long-term view to be taken and consideration of the likely timings of how and when a business will be sold and generate excess wealth.

- In all cases, the first step will be to review the business to determine whether it qualifies, fully or partially, for Business Relief or Agricultural Relief.
- The next step is usually to determine the needs and objectives of the current generation, taking into account family dynamics, financial needs, and business planning.
- Following this, appropriate options can be identified and decided upon by the family.

Get in touch.

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