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IHT Planning: Loan Trusts

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Inheritance tax (IHT) planning is becoming increasingly important for a growing number of individuals.

Inheritance tax allowances are currently frozen – the Nil-Rate Band (NRB) at £325,000 since 2009 and the Residence Nil-Rate Band (RNRB) at £175,000 since 2020 – both of which are not expected to increase until at least April 2031.

When combined with the [changes to inheritance tax on pensions](#) from 6th April 2027, many individuals are now assessing their options to reduce their estate's IHT liability and maximise the value passed onto their beneficiaries.

Different IHT planning strategies offer varying levels of effectiveness and control over capital, some of which use trust-based planning to achieve tax savings.

A trust is a legal arrangement where assets are held and managed by one party (the trustees) for the benefit of another (the beneficiaries). The individual transferring the assets to the trust is called the settlor.

Trust-based IHT planning involves transferring assets into trust, so they are no longer owned by the settlor for IHT purposes. Depending on how the trust is structured, this can reduce the value of the settlor's estate or remove future growth from it - this article will focus on Loan Trusts, which are designed to offer the latter.

A Loan Trust, as the name suggests, involves lending capital to a trust rather than making an outright gift to an individual or trust.

The loan itself can be repaid to the settlor on demand, on death, or through a series of regular repayments.

The lender retains the right to loan repayments until the original loan capital is fully repaid. The settlor can also reduce or waive the loan at any time, at which point it is treated as a gift for IHT purposes.

Loan Trusts can therefore be particularly suitable for individuals who wish to begin IHT planning but are not comfortable making outright gifts, as access to the loaned capital is retained.

[Offshore Bonds](#) are commonly used in Loan Trusts as they simplify the administration and tax reporting of the trust fund. Offshore Bonds also allow the trustees of the Loan Trust to utilise the 5% withdrawal allowance to make regular loan repayments without an immediate tax liability.

One of the key advantages of a Loan Trust is that the value of the loan is effectively “frozen” for IHT purposes. Any investment growth on the loaned capital occurs within the Loan Trust itself and therefore falls outside of the settlor's estate.

This is particularly important at present, when inflation is high and asset prices (including house prices) are increasing whilst the IHT nil-rate bands remain frozen for the next five years, at least.

In effect, a Loan Trust can be viewed as a strategy to help mitigate the impact of this “stealth” Inheritance Tax. However, the success of Loan Trust is dependent on the underlying investment performance of the trust fund, which cannot be guaranteed.

An additional benefit of a Loan Trust arrangement is that (unlike other IHT planning strategies) the loan itself and any investment growth on the loan does not use an individual's IHT nil-rate band.

This means that the seven-year rule does not apply and, as a result, removes the uncertainty associated with survival-based IHT planning strategies.

For those looking to use multiple IHT planning strategies, a Loan Trust can work well alongside outright gifts and gifts into trust, which are classed as a transfer of capital for IHT purposes and use an individual's nil-rate band.

The trade-off to this increased flexibility is that, unless the loan is reduced or waived, the outstanding balance remains part of the settlor's estate for IHT purposes. This means there is no immediate IHT saving when the Loan Trust is established, unlike other IHT planning strategies.

In summary, a Loan Trust allows an individual to preserve the value of invested capital for their beneficiaries in real terms without increasing their IHT liability and, if needed, to receive an ongoing income from the trust fund.

Loan Trusts often form part of a wider financial plan as they complement other IHT planning strategies, such as outright gifts or gifts into trust. It is therefore important to consider the whole range of IHT planning strategies before making loans to a trust.

As mentioned, successful IHT planning using Loan Trusts relies on future investment growth, which cannot be guaranteed. Therefore, regular reviews of the underlying investment strategy in a Loan Trust arrangement are key to ensuring it remains suitable and meets the individual's financial objectives.

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