Charitable trusts: the inheritance tax trap

Inheritance tax and trusts Personal tax

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Finance Act 2026 has created a potential inheritance tax trap for charitable trusts, making existing wills and succession planning urgently worth reviewing.

Key Points

What is the issue?

Finance Act 2026 has changed the inheritance tax exemption for charitable gifts made by will. Gifts on charitable trusts may no longer qualify for relief, and the absence of effective transitional provisions means the exemption may be irretrievably lost after the testator’s death.

What does it mean to me?

Practitioners should review existing wills containing charitable purpose trusts, as gifts that previously qualified for exemption may no longer do so. The article also considers whether a technical argument based on the registration condition could preserve relief in some cases.

What can I take away?
Where clients have existing wills leaving assets on charitable trusts, advisers should consider whether amendments or lifetime planning are needed before death. Otherwise, valuable inheritance tax relief may be lost, despite the charitable intention remaining unchanged.

Suppose that a person wishes to leave some or all of her estate to charity. In her will, she might make a gift:

- to an existing registered charity; or
- to trustees on trust for a particular charitable purpose (or for charitable purposes generally).

Until 6 April 2026, there was no distinction in the inheritance tax treatment of these two types of gift. In either case, the deemed transfer of value on death was exempt under Inheritance Tax Act (IHTA) 1984 s 23.

The ostensible effect of amendments introduced by Finance Act 2026, however, is that only gifts to existing registered charities now qualify for exemption. More significantly, the absence of any effective transitional provisions means that nothing can be done after the testator’s death to rescue exemption for a gift on charitable trusts. As a result, a significant number of existing wills may now require urgent review.

This article examines how these changes came about, why they create a potential trap for practitioners and clients, and what steps can still be taken to preserve relief.

How did we get here?

The background to the Finance Act 2026 changes lies in the rather complicated history of the inheritance tax charity exemption.

The original exemption

From its enactment, Inheritance Tax Act (IHTA) 1984 s 23(1) exempted transfers of value 'to the extent that the values transferred by them are attributable to property which is given to charities'. IHTA 1984 s 23(6) provided that property was 'given to charities' if it either became the property of charities **or** was held on trust for charitable purposes only. This mirrored the language of the capital transfer tax exemption in the Finance Act 1975 Sch 6 para 10.

The exemption therefore operated in two distinct ways. It applied where the property either became the property of charities (the first limb) or was held on trust for charitable purposes only (the second limb). This was confirmed by the Court of Appeal in *Routier v RCC* [2016] EWCA Civ 938.

The two limbs substantially overlapped. Before the changes introduced by Finance Act 2010 (discussed below), the definition of 'charity' for these purposes was the longstanding income tax definition: 'a body of persons or trust established for charitable purposes only'. As a result, a gift of property to trustees for charitable purposes would, on the face of it, satisfy both limbs. The property became the property of a trust established for charitable purposes only (limb 1), while also being held on trust for charitable purposes only (limb 2). In most, if not all cases, it was irrelevant which limb applied.

Routier exposes the distinction

The question of whether there was a material divergence between the two limbs arose in *Routier.* The deceased had left property to foreign trustees for purposes that were accepted to be charitable under English law. The gift could not be exempt from inheritance tax under the first limb because the income tax definition of 'charity' did not encompass foreign charities.

The House of Lords had previously held that the phrase 'established for charitable purposes only' contained an implicit limitation, applying only to bodies or trusts governed by the law of some part of the UK and subject to the jurisdiction of UK courts (*Camille and Henry Dreyfus Foundation Inc v IRC* [1956] AC 39).

The executors argued, however, that no equivalent limitation applied to the second limb and that gifts to foreign charitable trustees were exempt from inheritance tax. The High Court and Court of Appeal found in HMRC's favour. The Supreme Court ultimately decided the case for the taxpayers on a separate point of EU law but expressly left this question unresolved.

The Finance Act 2010 definition

The reference to EU law brings us to the new definition of ‘charity’ introduced by the Finance Act 2010 Sch 6, with effect for all tax purposes, including inheritance tax, from 1 April 2012. (Although the litigation in *Routier* took place after that date, the deceased died in 2007 and the case therefore depended on the earlier law.)

A series of decisions of the CJEU, particularly *Persche v Finanzamt Lüdenscheid* (Case C-318/07), had made it clear that restricting charitable tax reliefs to charities established in the relevant member state contravened the free movement of capital. The new definition was intended to comply with EU law while retaining a degree of control over gift aid claims involving foreign charities.

The Finance Act 2010 Sch 6 definition accordingly required that for a body of persons or trust to qualify as a ‘charity’ for tax purposes, it must not only be established for charitable purposes only, but also meet:

- the ‘jurisdiction condition’: be subject to the control of the High Court, the Court of Session or the High Court in Northern Ireland in the exercise of its jurisdiction with respect to charities or be subject to the control of a court exercising a corresponding jurisdiction in an EU or EEA state;
- the ‘registration condition’: ‘comply with any requirement to be registered’ with the Charity Commission or an equivalent body outside England & Wales; and
- the ‘management condition’: have managers who pass a ‘fit and proper persons’ test.

The UK’s departure from the EU removed the need to extend charitable tax reliefs to EU and EEA charities. Parliament could, in principle, simply have repealed Finance Act 2010 Sch 6 and reinstated the previous definition. Instead, Finance (No.2) Act 2023 narrowed the jurisdiction condition so that it could only be satisfied if the body of persons or trust was subject to the jurisdiction of the UK courts. The registration and management conditions remained unchanged.

The important point is that the Finance Act 2010 Sch 6 definition also introduced, as a by-product, a clear (rather than merely arguable) divergence between the two limbs of the exemption in IHTA 1984 s 23. A gift to a charitable company depended on the first (‘property … becomes the property of charities’) and therefore required the charity to satisfy the jurisdiction, registration and management conditions. By contrast, a gift to a charitable trust, whether existing or newly created, fell within the second limb (‘property … is held on trust for charitable purposes only’), to which those conditions were on the face of it irrelevant. The divergence became even wider following the narrowing of the jurisdiction condition by Finance (No.2) Act 2023.

The Finance Act 2026 amendments

One might reasonably ask how much this actually mattered. For gift aid purposes, there was no question that relief was available only on donations to charities satisfying the Finance Act 2010 Sch 6 conditions. But was it really a problem that inheritance tax relief might be available on gifts to foreign charitable trusts? Or that it was available on bequests to newly established charitable trusts where the trustees had not registered with the Charity Commission before the deceased’s death?

The government has evidently decided that the answer to both questions is ‘yes’. The explanatory notes to the relevant clause of the Finance (No.2) Bill 2025-26 described the measure (somewhat hyperbolically) as an ‘anti-avoidance change’. In substance, its purpose was to ensure that gifts to charitable trusts meet the same jurisdictional and regulatory requirements as other charities.

The effect of Finance Act 2026 s 78 is simple. The words ‘or is held on trust for charitable purposes only’ have been removed from Inheritance Tax Act 1984 s 23(6)(a). In other words, the second limb of the exemption has been deleted.

The transitional relief in Finance Act 2026 s 79 is very narrowly targeted. It applies only where property becomes held on trust for charitable purposes on the termination of a qualifying interest in possession. In those circumstances, relief is available if, within two years of the termination, the property becomes the property of charities meeting the Finance Act 2010 Sch 6 conditions.

The absence of equivalent provision where an individual has left property by will on trust for charitable purposes is something of a mystery. The logic is presumably that an interest in possession beneficiary or trustees may have no power to amend the remainder trusts, whereas a testator could always amend his will during his lifetime. But what if – as will inevitably happen in many cases by inadvertence – he does not?

That question is considered next.

Finally, there is no change to the exemption of charitable purpose trusts from ten-year anniversary and exit charges under the inheritance tax ‘relevant property’ regime. Finance Act 2026 makes no amendment to IHTA 1984 s 58(1)(a), which provides that ‘property held for charitable purposes only’ is not ‘relevant property’.

Position after death

Suppose that several years ago Anna, a long-term UK resident, made an English law will leaving the residue of her estate to UK resident trustees on trust for such charitable purposes as the trustees should, in their discretion, determine. She dies after 5 April 2026 without having changed her will.

Her trustees would satisfy the jurisdiction condition in Finance Act 2010 Sch 6 and, assuming they are fit and proper persons, the management condition. However, because the trust did not exist before Anna’s death, the trustees will not have registered with the Charity Commission and so will not satisfy the registration condition. The consequence is that the residuary gift does not attract exemption from inheritance tax. Nor can the 36% inheritance tax rate, where at least 10% of an estate is left to charity, apply because that depends on the charitable gift falling within IHTA 1984 s 23(1).

The next question is whether exemption can be saved by anything done after death. Suppose that Anna’s trustees either register with the Charity Commission or appoint the trust property to existing registered charities. Do any of the inheritance tax provisions allowing post-death events to be ‘read back’ into the deceased’s will apply? The answer appears to be no.

IHTA 1984 s 144(1) applies, broadly speaking, where property settled by will is distributed within two years of death. In such cases, the Act applies as if the deceased’s will had passed the property directly to the beneficiary. However, s 144(1) only applies where, within two years of death, an event occurs that would otherwise give rise to an exit charge. Property held on trust for charitable purposes remains outside the scope of the relevant property regime. Accordingly, on the facts of Anna’s estate, no exit charge could arise and s 144(1) cannot apply.

IHTA 1984 s 142(1) applies where any disposition of the deceased's estate is varied, or the benefit conferred by a disposition is disclaimed, within two years of death. Again, the Act applies so as to read back the variation into the will. However, s 142 requires the variation or disclaimer to be made 'by the persons or any of the persons who benefit or would benefit from the dispositions'.

On the face of it, Anna's trustees cannot be 'persons who benefit or would benefit', since trustees do not hold trust property for their own benefit. Nor is there anyone else who could enter into an instrument of variation under s 142, because a trust for charitable purposes by its nature has no ascertainable individual beneficiaries.

Conundrum

The position on Anna's death, however, may not be as clear cut as it first appears, leaving room for a different conclusion. In particular, satisfying the registration condition does not require that the charitable trust is actually registered with the Charity Commission. Rather, Finance Act 2010 Sch 6 para 3(2) requires only that 'the … trust has complied with any requirement to be registered'. This brings Charities Act 2011 s 30(2) into play. Under s 30(2)(d), a charity whose gross income does not exceed £5,000 is exempt from registration. Section 30(4)(a) provides that a charity's gross income is determined by reference to its financial year immediately preceding the relevant time.

The charitable trust in the example only comes into existence on Anna's death. It is therefore arguable that:

- the charitable trust had no financial year immediately preceding Anna's death, and therefore had no gross income exceeding £5,000;
- the charitable trust is therefore exempt from registration under Charities Act 2011 s 30(2)(a); and
- having no registration requirement to be satisfied, it had 'complied with any requirement to be registered' and thus met the registration condition.

If that argument is correct, the effect of the Finance Act 2026 amendments is, in substance, limited to denying relief (assuming it was available prior to 6 April 2026) for gifts to foreign charitable purpose trusts. The gift in Anna's will would therefore be exempt after all.

It would no doubt be optimistic to plan on the basis of this argument. However, it may provide a viable defence where an old will containing a charitable purpose trust has simply not been updated before the testator's death after 5 April 2026.

Conclusion

The long and the short of it is that, where a person dies after 5 April 2026 leaving property on trust for charitable purposes rather than to existing registered charities, exemption under IHTA 1984 is likely to be unavailable (subject to the argument considered under the 'Conundrum' above). More importantly, once the testator has died, that relief is likely to be irretrievably lost.

It is difficult to see any policy justification for this state of affairs. In particular, it is difficult to see why transitional protection, similar to the terms provided by Finance Act 2026 s 79, should not also have applied to property settled on charitable purpose trusts by will, rather than only where property becomes held on charitable purpose trusts on the termination of a qualifying interest in possession.

In the absence of legislative reconsideration, persons with existing wills containing gifts on charitable trusts seem to have two options. The first is to execute a codicil amending the will so that the property in question is left to existing registered UK charities. The second is to establish the charitable trust in question during the testator's lifetime with a nominal amount, so that the trust qualifies as a 'charity' within Finance Act 2010 Sch 6 before the testator's death. The trustees could then either register with the Charity Commission or, since registration is often a lengthy process, rely on the exemption in Charities Act 2011 s 30(2)(d). The charity may also be registered with HMRC Charities through a simpler online process.