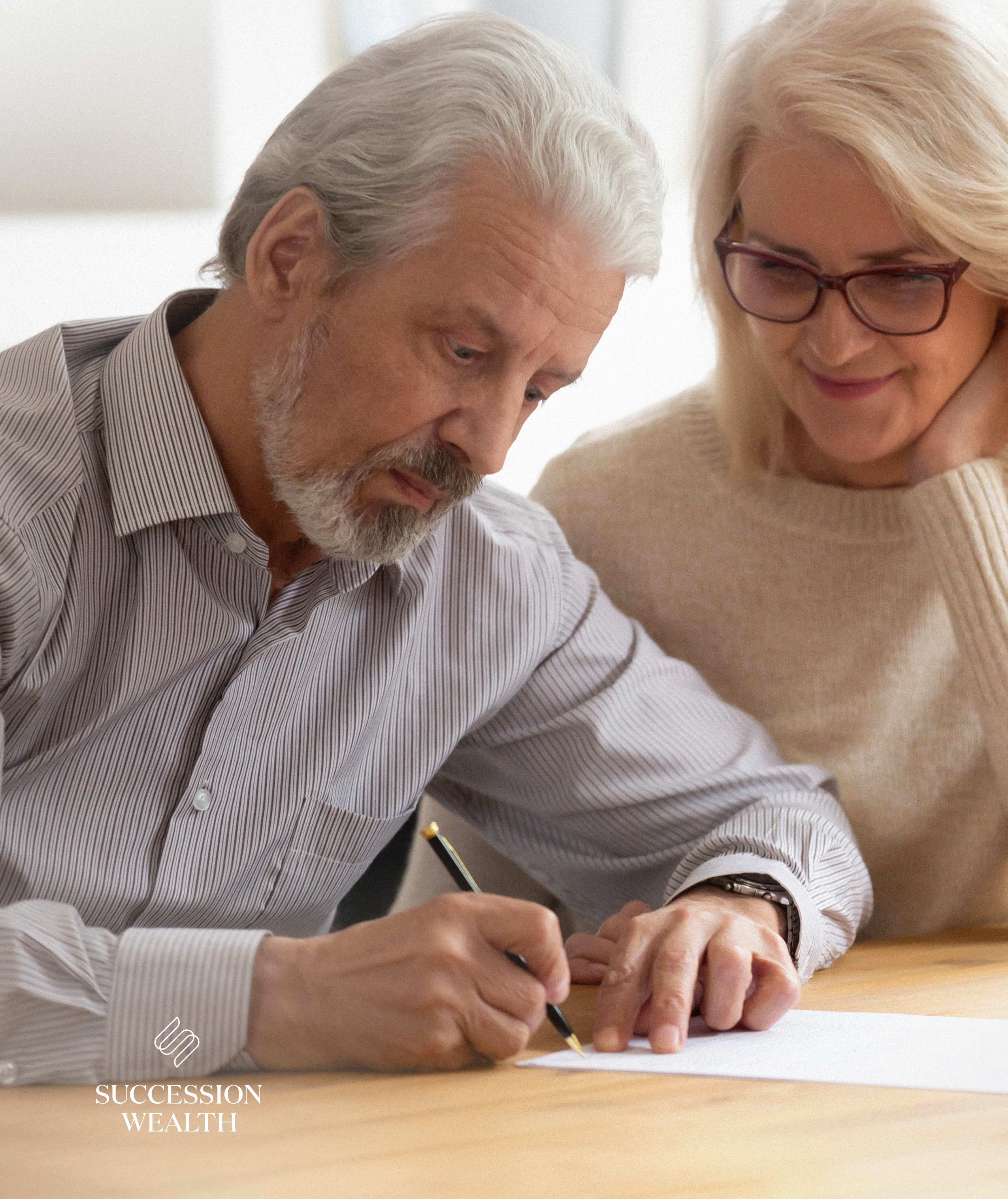
A Guide to Inheritance Tax and Gifting



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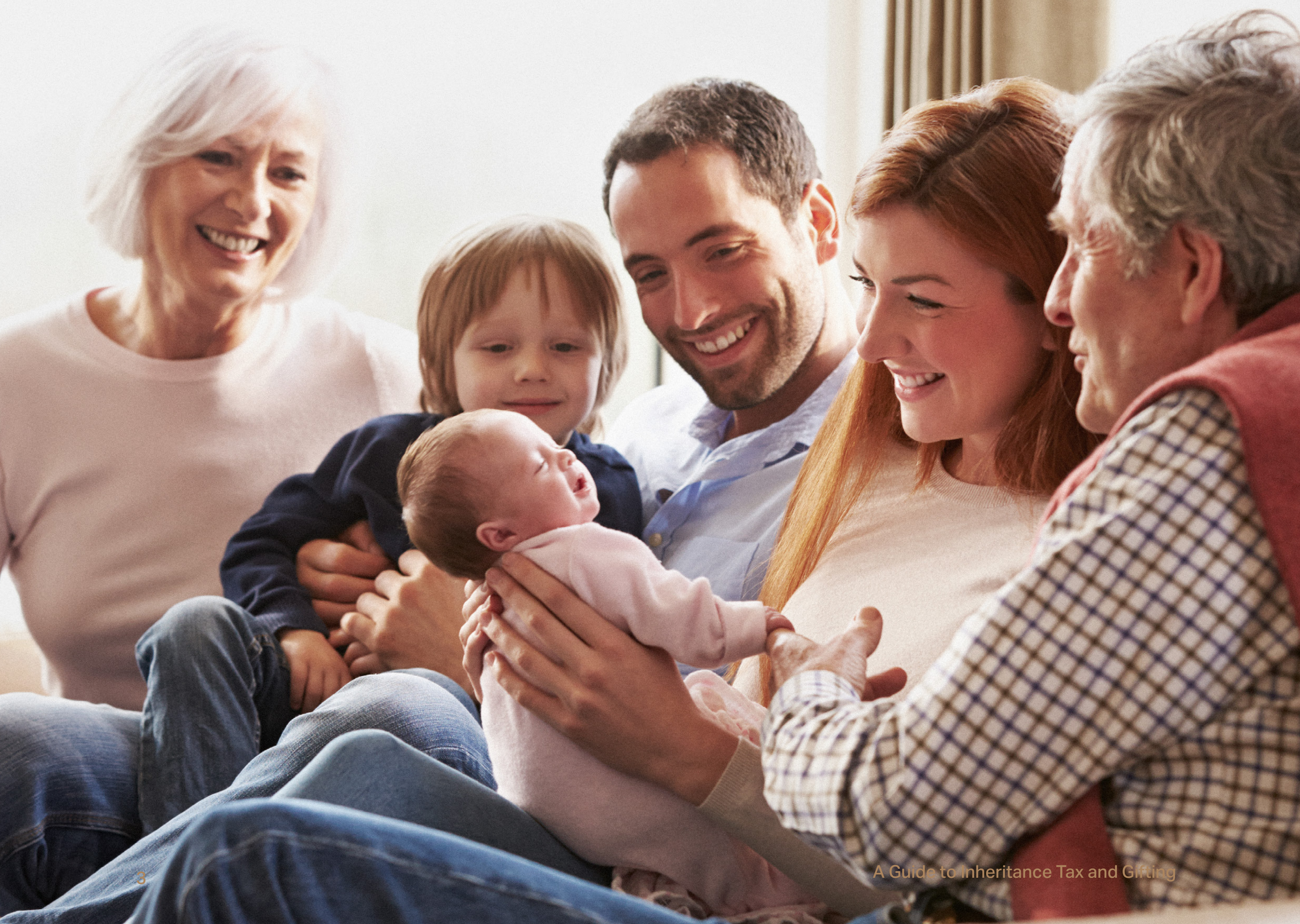
Inheritance Tax (IHT) and Gifting

There are many things we would like to leave for our loved ones when we pass away, from fond memories to heirlooms, but the one thing we don't want to pass on is a hefty IHT bill.

There are steps you can take to lessen your IHT burden, including making gifts during your lifetime. This guide provides an overview to help you understand what the tax is, and some of the measures you can take to help to mitigate it.



How much tax will I have to pay?

IHT is a tax on the estate (that is the property, money and possessions) of a person who has passed away.

Currently unused pension funds do not form part of your estate for IHT purposes. However, this exemption will be removed from April 2027, at which point unused pension funds will also be included in the value of your estate.

IHT is only payable if the value of an estate exceeds certain thresholds.

The main threshold, known as the nil-rate band, is currently £325,000.

An additional £175,000 is available via the residence nil-rate band, if the deceased's home is passed to direct descendants.

These thresholds will remain frozen until April 2030.

If the value of your estate is below the IHT thresholds, no IHT will be due. If your estate exceeds the thresholds, the standard rate of IHT payable is 40% of the excess.

As a simple example, if you died with an estate worth £675,000 and left your main home to your child, you would typically pay IHT on the value of your estate above £500,000. Therefore, in this instance, your IHT bill would be 40% of £175,000, or £70,000.

According to figures issued by the government, 4.39% of UK deaths resulted in an IHT charge in the tax year 2021 to 2022.[1]

[1] 31st July 2024 | Inheritance Tax liabilities statistics: commentary | Gov.uk

What tax benefits do couples get?

Transfers between spouses or civil partners are exempt from IHT, therefore your partner could inherit your entire estate without having to pay an IHT bill. They also inherit any unused IHT allowances when you pass away. This means that if you didn't use any of your allowances, they'd have an allowance of £1 million - as long as you leave your home to your children or grandchildren.

Important

Note there is a tapered withdrawal of the additional nil-rate band for estates with a net value of more than £2 million. The withdrawal rate is £1 for every £2 over the threshold.

A brief history of Inheritance Tax

IHT has existed in one form or another since roughly the 17th century. It was first brought about in 1694 to help finance a war against France and, over the years, it has had various incarnations.

- Probate Duty 1694
- Legacy Duty 1780
- Succession Duty 1853
- Estate Duty 1889
- Capital Transfer Tax 1975
- Inheritance Tax 1986

Gifting and Inheritance Tax

If IHT is likely to be due on your estate, there are ways to reduce the amount payable.

Giving gifts is one way to reduce the value of your estate, and potentially reduce the size of your IHT bill.

It is important to keep accurate records of any gifts that you make. These records will help the executor of your Will to work out the total value of your estate when you've passed away. Without them, your estate may be liable for more IHT than it should be.

The records should include:

- What gift you gave
- Who you gave it to
- When you gave it
- How much the gift is worth

What gifts are free from Inheritance Tax?

There are two types of gifts; those that are considered outside of your estate immediately and those that are potentially exempt depending on when they're given and when you pass away.

1. Potentially Exempt Transfers (PETs)

Theoretically, you can give gifts of unlimited value, and they won't be considered part of your estate for IHT purposes. Such gifts are called 'Potentially Exempt Transfers' or PETs.

PETs must meet certain conditions. For example, you can only gift to another individual or into some Trusts (not all gifts to Trusts are eligible). You cannot make a gift to or from a company.

In order for a gift to be exempt you must survive more than seven years after giving it.

If you pass away within seven years, then the value of the gift is added back to the value of your estate and IHT will be payable on a sliding scale, depending on how long you survived after making the gift. This is called the 'seven-year rule'.

The table below shows the IHT payable on a gift, depending on how much time has elapsed:

Years between gift and death	Tax to pay on gift
Less than 3 years	40%
3 – 4 years	32%
4 – 5 years	24%
5 – 6 years	16%
6 – 7 years	8%
7+ years	0%

What gifts are free from Inheritance Tax

2. Gifts to spouse or partner

You don't have to pay IHT on any gifts you give to your spouse or civil partner. This means you can gift your partner as much as you like in your lifetime, as long as they live in the UK permanently.

Furthermore, married couples and civil partners are allowed to pass on their entire estates to their spouse tax-free when they pass away.

As we mentioned earlier, partners can also inherit their deceased spouse's unused IHT allowances.

For example, if a husband dies and leaves his entire estate to his wife, she can take his unused tax allowance and add it to her own.

3. Annual exemption

Each tax year (6th April to 5th April) you can give away £3,000 worth of gifts without their value being added to your estate. This is called your 'annual exemption'.

This exemption can be carried over from the previous year, but only up to a value of £6,000, so if you're looking to use gifts to reduce the value of your estate, you need to carefully manage it.

4. Small gifts

You can give gifts of up to £250 to as many individuals as you like in any tax year. However, you cannot give one of these gifts to someone who has already received your whole £3,000 annual exemption.

5. Weddings

Marriages and civil ceremonies are another opportunity to give gifts tax-free and the amount that you can gift varies depending on who is getting married.

Typically, you can give a gift of up to £1,000 per person without the amount being included in the value of your estate.

However, this amount may be greater if you're gifting to family. If one of your children is getting married, then you can give up to £5,000 without it being added to the value of your assets, while you can gift up to £2,500 to a grandchild or great-grandchild.

6. Gifts from income

If you have enough income to maintain your usual standard of living, you can gift surplus income - for example, by paying it into a child's savings account.

This can be a very valuable IHT exemption, but it is also complicated, and this is why it's particularly important that you keep good records of your gift-giving if you're planning to gift in this manner.

For this exemption to apply you must meet three conditions:

- The gift must be made out of income 'taking one year with another'.
- The gift formed part of your normal expenditure – this generally means that the gift should be regular in terms of value and frequency.
- You should be left with enough income to maintain your standard of living.

One of the tests that HMRC use to determine whether gifting in this way is allowed due to excess income is to see whether the gifts you give are regular. Typically, there needs to have been an established pattern of gift-giving to satisfy them that it is a normal expenditure. Because of this, if you do intend to gift in this way, make sure that you can maintain the regular payments, and keep good records.

For example, Mr Smith is 80 years old and retired. He has a steady income of £60,000 per year, consisting of pensions and investment income. He can save £2,500 per month or £30,000 per year.

For the last five years, Mr Smith has been making regular monthly gifts out of his surplus income of £1,000 per month to his son and daughter. As he has been giving the gift regularly for such a long time, HMRC will likely accept that this is a normal expenditure.

If HMRC does accept these gifts are part of his normal expenditure, Mr Smith will still be able to make use of his annual £3,000 IHT allowance.

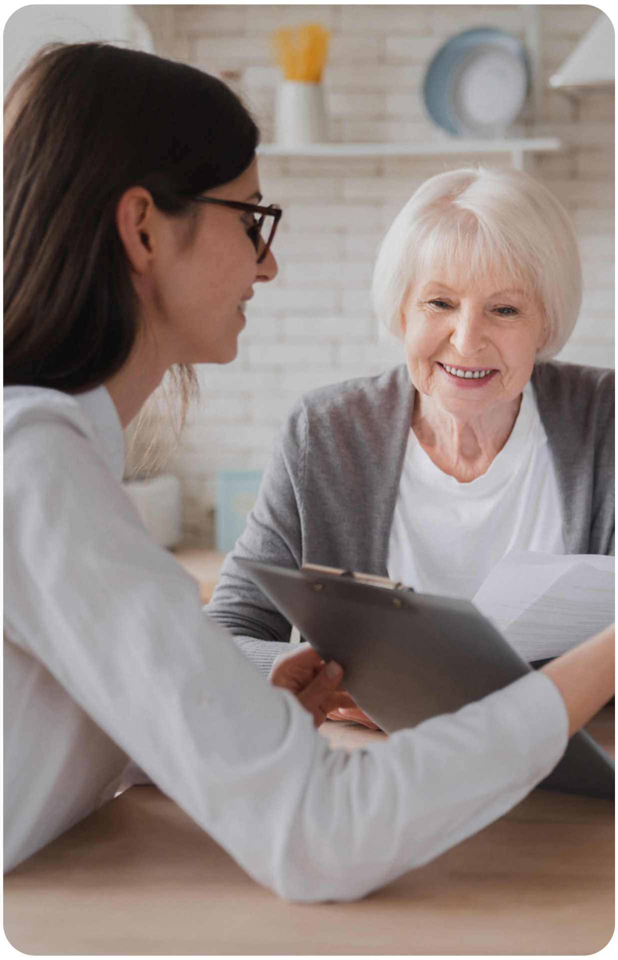
Leaving gifts in your Will

If you want your money to go to a good cause after you die as well as reducing your IHT bill, you may want to consider leaving some of your money to charity in your Will.

To encourage more people to give money to charity, any cash, or asset that you leave to a charity, either during your lifetime or in your Will, will be exempt from IHT.

Furthermore, leaving money to a charity in your Will can reduce the overall amount of IHT that is due on your estate, potentially bringing the value of your estate below the threshold of the nil-rate band.

If you leave at least 10% of your estate to charity in your Will, the Government will reduce the amount of IHT you have to pay from 40% to 36%.



Reliefs when gifting certain assets

Certain assets also receive relief from IHT when they are gifted, although to successfully get relief they must meet certain criteria. Currently:

— **Business Property:**

If you own a business, you may be eligible for Business Property Relief, which can reduce the value of a business property by up to 100% when it's being transferred. This transfer can be made in life or as part of a Will, as long as the business has been owned for at least two years.

— **Agricultural Property:**

If you own a farm, you can pass it on free from IHT, although it must meet certain conditions. Certain farm assets, such as agricultural machinery, are also not exempt.

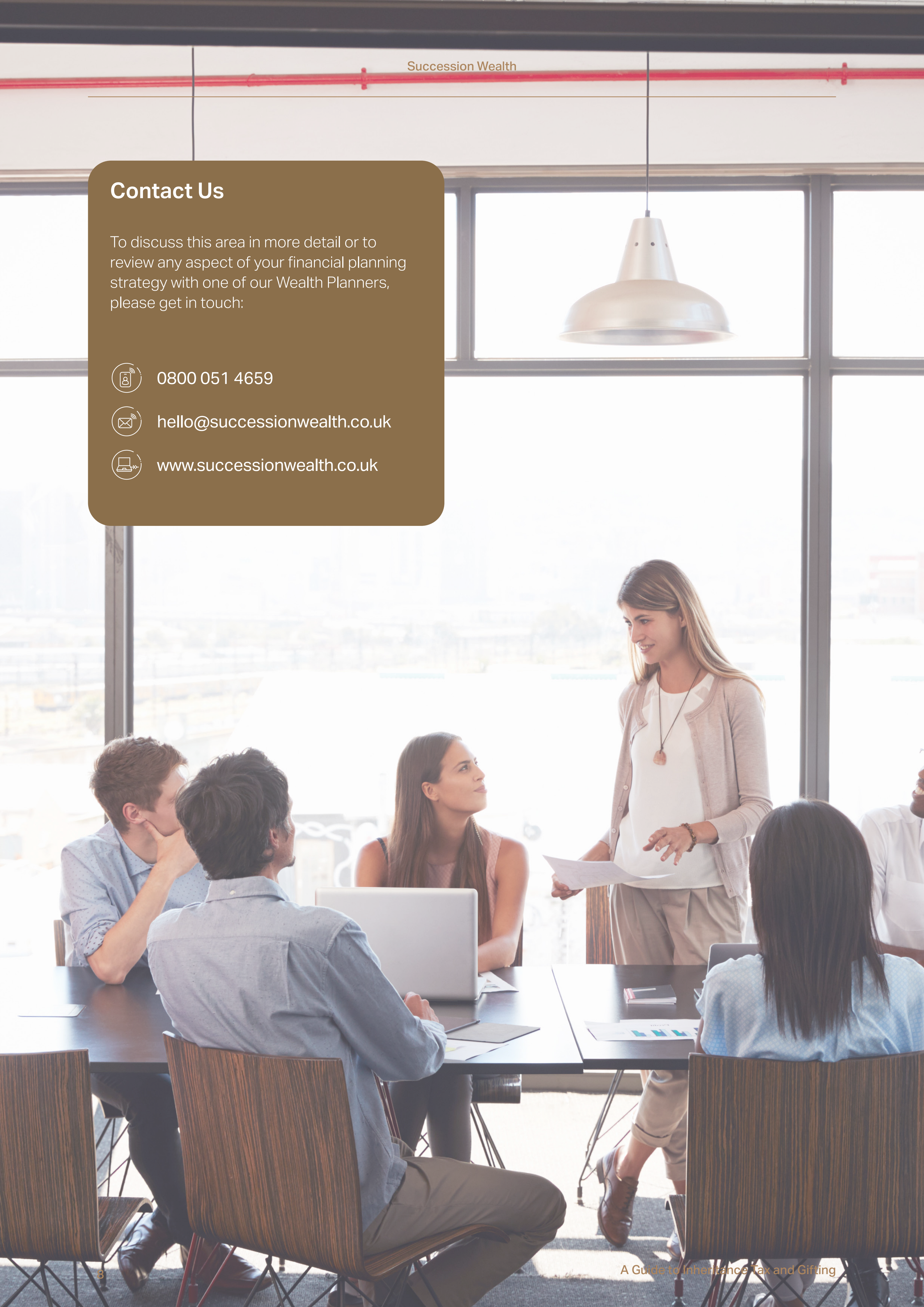
— **Woodland Property:**

Woodlands used for commercial purposes can potentially get IHT relief of up to 100%. If the land is used for timber, the tax can also be postponed until the trees are felled, provided that you have owned the woodland for five years before your death.

From 6th April 2026, the full 100% relief from IHT will be restricted to the first £1 million of combined agricultural and business property. Above this amount, landowners will pay IHT at a reduced rate of 20%, rather than the standard 40%. This tax can be paid in installments over 10 years interest free, rather than immediately, as with other types of IHT.

All of the other spousal exemptions and nil-rate bands will still be available in addition to these reliefs.

These are only a few of the variety of reliefs that you can potentially apply for but working out which properties are eligible for relief can be confusing. There are also many other steps that may be appropriate for you if you're worried about IHT.



Contact Us

To discuss this area in more detail or to review any aspect of your financial planning strategy with one of our Wealth Planners, please get in touch:

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Please Note

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The information is aimed at retail clients only.

The Financial Conduct Authority does not regulate advice on taxation, Trusts, Estate Planning, or Will writing.

The content was accurate at the time of writing, changes in circumstances, regulation and legislation after the time of publication may impact on the accuracy of the guide.

This information is based on our current understanding of taxation legislation and regulations. Any levels and bases of, and reliefs from, taxation are subject to change and tax implications will be based on your individual circumstances.

You should seek legal advice to ensure that your Will reflects your wishes and is legally binding.

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