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How to reduce Inheritance Tax by leaving a gift

Planning for your wealth preservation and the eventual transfer of that wealth

When you've worked hard and invested carefully to build your wealth, you want to look after it. That's why it's important to plan for your wealth preservation and the eventual transfer of that wealth.

If you're considering making a gift to someone, there are a few things you need to know about Inheritance Tax. Gifts can be a great way to reduce the amount of Inheritance Tax that your family will have to pay when you die, but there are some rules that you need to follow.

MAKE USE OF THE ANNUAL EXEMPTION

Inheritance Tax is a tax that is levied on the estate of a person who has died. The estate is the value of all the property and assets that the person owned at the time of their death (with some exceptions for certain business assets and pension funds). Inheritance Tax is charged at 40% (tax year 2022/23 – a UK tax year runs from 6 April to the following 5 April) on anything above the Inheritance Tax threshold, which is currently £325,000.

There are some gifts that are exempt from Inheritance Tax, such as gifts to your spouse or registered civil partner, or gifts to charities. However, you can also reduce the amount of Inheritance Tax that your family may have to pay by making use of the annual exemption and also carrying forward any unused annual exemption from the previous year.

AVOID PAYING INHERITANCE TAX

If you're thinking about making a gift, there are a few things you need to bear in mind. Firstly, you need to make sure that the gift is genuine and that you're not just trying to avoid paying Inheritance Tax. Secondly, you need to consider whether the person you're giving the gift to can afford to pay any Inheritance Tax that might be due on it (which would apply if the cumulative gift exceeds your nil rate band). And finally, you need to think about what will happen to the asset after you die.

You can make exempt gifts of up to £250 as long as each gift goes to a different person and each person has had no more than £250 from you in gifts in that tax year. This will commonly include birthday and Christmas gifts.

MONEY OR ITEMS OF PROPERTY

A wedding gift from a parent to their child of up to £5,000, from grandparent to grandchild of up to £2,500, or up to £1,000 to someone else, is also exempt.

In addition, each tax year you have what's known as an annual exemption. Under this you can give away money or items of property to the value of £3,000. This can all go to one person or be shared between several people. And if you didn't use that

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exemption in the previous tax year, you can use it in the current tax year and give away £6,000.

MAKING REGULAR PAYMENTS

Known as 'normal expenditure out of excess income', you're able to make regular payments from income you don't need to maintain your normal standard of living. For example, if you wanted to pay a loved one's rent or mortgage, or make regular payments into a savings account for your grandchild.

There isn't a limit on how much you can give away and, like the exempt gifts above, the amount you gift will leave your estate straight away. But you must be able to afford the payments after your regular living costs and without having to cut back. Plus the payments need to come from your normal monthly income.

WORKING OUT IF THERE'S TAX TO PAY

If you wanted, you could combine regular payments with your annual exemption in the same tax year so that one person can receive even more. It's important to consider carefully how much you can afford – although you may not need the money now, your circumstances in the future could change.

Keeping a record of the gifts you give is essential. It helps you show which are exempt and which may have to be included as part of your estate. And in the event of your death, it will also help those responsible for the administration of your estate when it comes to claiming any allowances and working out if there's tax to pay.

NON-EXEMPT GIFTS

If you wish to make larger gifts that fall outside the above exemptions, those gifts won't fall out of your estate for Inheritance Tax purposes for 7 years. ■

READY TO DISCUSS HOW TO PROTECT AND PASS ON YOUR WEALTH?

We are living in an unprecedented age of personal wealth. Many of today's baby boomer generation are far wealthier than any before, built on the back of generous pensions, secure high paid jobs and soaring property values. But for many of the next generation, future financial security and goals may be increasingly reliant on receiving a sizeable inheritance. To discuss how to protect and pass on your wealth, please contact us.