

Reducing Inheritance Tax on your Estate

After they have passed away, most people would want their money and possessions to go to their friends, family, or good causes. Inheritance tax may not affect you personally after you are gone, but the more tax which your estate has to pay, the less value will pass to the people whom you wish to benefit.

Fortunately, there are many ways in which you can reduce your estate's inheritance tax bill. This help guide looks at how inheritance tax works and some of the steps you can take to reduce the amount your estate may have to pay.

The basics of Inheritance Tax

When you pass away, your estate will be valued for inheritance tax. In general, your 'estate' refers to everything that belongs to you (including money in bank accounts, property, and personal belongings) along with any debts.

The total value of your estate largely determines how much inheritance tax will be payable on it. Some lower-value estates may not have to pay any inheritance tax. There are also several exemptions, reliefs, and other tax-saving methods which can reduce (sometimes entirely) the value of your estate which is assessed for tax. These are discussed later in this help guide.

In addition, every individual has an inheritance tax 'Nil Rate Band'. Money, assets, or property up to the value of this Nil Rate Band is taxed at 0%, which means no tax is paid on it. Currently, the Nil Rate Band value is £325,000 and it will stay at this level until the 2020/2021 tax year at least.

For anything above the Nil Rate Band threshold, the normal inheritance tax rate of 40% will apply.

Example - Nil Rate Band

Stanley dies, and the total value of his estate comes to £350,000. His Nil Rate Band means that £325,000 of this will be taxed at 0%, and the remaining £25,000 will be taxed at 40%. His inheritance tax bill will be £10,000.

Inheritance Tax in life and on death

As mentioned above, inheritance tax looks at the value of your estate on death. It is tempting therefore to think that, by giving assets away before you die, you will reduce the amount of inheritance tax payable.

Unfortunately, the situation is more complicated than that. Inheritance tax law has various provisions which mean gifts (and other actions which transfer value away from your estate) could be assessed for inheritance tax too. Certain kinds of gift may even trigger an immediate inheritance tax charge during your lifetime.

What lifetime gifts will be assessed for Inheritance Tax?

There are three broad categories of lifetime gift which may attract inheritance tax.

These are:

- Potentially Exempt Transfers ('PETs').
- Gifts you have made where you kept some benefit from the asset you gave away e.g. where you give your house away but continue to live in it. These are known as 'gifts with reservation of benefit'.
- Transfers which attract immediate inheritance tax charges.

Potentially Exempt Transfers (PETs)

Lifetime gifts which are not exempt from inheritance tax are almost always treated as PETs. PETs have the possibility of being completely exempt from inheritance tax, but only if you survive the gift by more than 7 years. If you make a gift to someone and then die within 7 years of making the gift, the value you transferred will be taken into account in your estate's assessment for inheritance tax.

The purpose behind your gift does not matter. The assessment for inheritance tax will only look at the amount by which the value of your estate has been reduced, not at the benefit the recipient gets from your gift.

Gifts with reservation of benefit

This covers situations where you have given a gift 'in name only' but continued to enjoy the benefits of the asset 'gifted'. An example would be giving your house to your children but continuing to live in it rent-free or giving a painting away but keeping it hanging on your wall. On your death, the house or painting would still be considered part of your estate for inheritance tax purposes because you have kept the benefit of it. Anything that demonstrates you no longer own the gifted property, such as paying rent at market rate for staying in the house, will often be enough to show you have not retained a benefit.

If the gift would be exempt from inheritance tax anyway – such as if you have given it to your spouse or civil partner – then there is no need to worry about inheritance tax on the gift. It will not be payable whether you have reserved a benefit or not. See below for more detail on exemptions like this.

Lifetime transfers attracting immediate Inheritance Tax charges

Some gifts you make during your lifetime may be considered 'chargeable lifetime transfers'. These are generally found in situations where inheritance tax could be avoided by passing value from your estate into other legal entities which do not normally attract inheritance tax. These transfers will attract an immediate charge to inheritance tax.

For example:

- Gifts made to a company.
- Gifts into certain kinds of Trust. More information on Trusts can be found in our [help guide](#): 'Trusts - Detailed Guidance'.
- Gifts made **by** 'close companies' – the definition of a close company is detailed but, in general, most small private companies would meet the definition.

The provisions surrounding these 'lifetime chargeable transfers' are complicated and beyond the scope of this help guide. For further information, please do not hesitate to [contact us](#).

What should I do about lifetime transfers?

If you are considering making any significant gifts during your lifetime, it is recommended that you take specialist advice. The tax implications of making a gift can then be explored in relation to your specific circumstances.

A further point to be aware of is that the person who has received your gift may have to pay the inheritance tax themselves, if you have not outlived the gift by 7 years, although in some cases the people administering your estate may agree to pay it instead.

How can I reduce my inheritance tax?

Make a Will

Many of the ways to reduce your inheritance tax bill can only be accomplished if you have control over what happens to your assets after you are gone. Making a Will is the only way you can set out your post-death intentions and give effect to them. If you do not have a valid Will in place, your entire estate will pass according to the '[intestacy rules](#)' and you will have no opportunity to arrange your affairs to make them tax-efficient.

For more information on making a Will, have a look at our website or get in touch with us.

Make use of exemptions

Gifts to certain people or organisations are exempt from inheritance tax – whether they are made during your lifetime or upon death. This exemption means that qualifying gifts will not use up any of your Nil Rate Band and no tax will be payable on them. You can take advantage of these exemptions to reduce your inheritance tax bill.

Gifts to the following are exempt from inheritance tax:

- Your spouse or civil partner.
- Charities.
- Political parties.
- Housing associations (if it is a gift of land).
- Heritage maintenance funds.
- Certain institutions which provide benefits to the nation (such as museums, galleries, and university libraries).

There are some other possible exemptions which **apply to lifetime gifts** only.

These are:

- **Small gifts** – You can make gifts totalling up to £250 to any one individual during a tax year and these will be exempt from inheritance tax. However, if the total to any one person exceeds £250, the entire amount will be subject to inheritance tax. The exemption does not operate like a Nil Rate Band – even the first £250 will be subject to inheritance tax if the limit is exceeded.
- **Normal expenditure** – If you make gifts in a regular pattern to meet some purpose, these gifts could be exempt from inheritance tax. An example would be regularly paying for a grandchild's school fees. However, you must also have enough income to maintain your 'usual standard of living' (after making the gifts) for the exemption to apply.
- **Wedding or civil partnership gifts** – An exemption applies to gifts given in respect to a wedding or civil partnership. The amounts vary depending on your relationship to the couple:
 - Parents can give £5,000 each.
 - Grandparents (or remoter ancestors like great-grandparents) can give £2,500 each.
 - Either of the couple can give to each other £2,500.
 - Anyone else can give £1,000.
- **Annual exemption** – If no other lifetime exemptions apply, there is an annual exemption of up to £3,000 per tax year. Unused amounts of this exemption can be carried forward for a maximum of one tax year.

Example – Using an Annual Exemption

Reginald makes a gift of £8,000 in 2016. He dies in 2017. This is a PET but as he has not survived the gift by more than 7 years it will be chargeable for inheritance tax. No Taper Relief (see below) will apply either as he did not survive the gift by more than 3 years. However, his annual exemption of £3,000 can be applied.

Reginald had not made any gifts in the tax year prior to his gift so he can also transfer his unused annual exemption from that previous year. His total annual exemption will therefore be £6,000. Applying this leaves only £2,000 of the gift to be included in Reginald's inheritance tax calculation. Assuming Reginald had made no other chargeable gifts in his lifetime, this will then 'use up' the first £2,000 of his Nil Rate Band.

Use the Residence Nil Rate Band

This is a relatively new inheritance tax provision which allows an extra Nil Rate Band to be applied to your home if you are leaving it to 'direct descendants'. It can be added to your normal Nil Rate Band and any transferred Nil Rate Bands (described below).

For more information on the [Residence Nil Rate Band](#), please see our additional help guide.

Transfer 'unused' Nil Rate Bands

Unused portions of a Nil Rate Band can be transferred between spouses or civil partners, adding to the total Nil Rate Band that may be applied. Any unused Residence Nil Rate Band (mentioned above) can also be transferred in a similar way, subject to conditions.

Example – Transferring unused Nil Rate Band

Euphrasie dies in 2017 with an estate valued at £565,000. She leaves £65,000 to her son, Hector, and the remaining £500,000 to her husband Jim. Because of the spouse exemption, none of the £500,000 passing to Jim will be subject to inheritance tax. It will therefore not 'use up' any of Euphrasie's Nil Rate Band. The £65,000 to Hector will, however, meaning £260,000 of her original £325,000 Nil Rate Band will be unused. Euphrasie's estate will not pay any inheritance tax, but 80% of her Nil Rate Band has not been used.

When Jim dies, he can add the unused percentage of Euphrasie's Nil Rate Band to his own Nil Rate Band. This is transferred as a percentage because the actual Nil Rate Band at the time of Jim's death may be different from that at the time of Euphrasie's. The figure he can apply will not necessarily be £260,000.

However, assuming the Nil Rate Band is unchanged at the time of Jim's death, he would be able to apply his own Nil Rate Band of £325,000 plus 80% of Euphrasie's unused Nil Rate Band (£260,000) to have a total Nil Rate Band of £585,000.

Make use of reliefs

Some reliefs are available to reduce the amount of inheritance tax payable on certain assets or property. In some situations, this may reduce the tax on them to zero.

The main two reliefs for inheritance tax are:

- Business property relief
- Agricultural property relief

For more information on these reliefs, read our [article](#) on our website which gives more information about how and when they can be applied.

Make lifetime gifts early

It is important to be aware that the longer you outlive a PET the less of a charge to inheritance tax it will attract. This gradual reduction is called 'Taper Relief'.

Taper relief takes effect as follows:

- If you die within 0 to 3 years of making your gift, there will be no reduction to the inheritance tax you pay on it.
- Over 3 years but less than 4, the inheritance tax payable will be reduced by 20%.
- Over 4 years but less than 5 reduces inheritance tax by 40%.
- Over 5 years but less than 6 reduces inheritance tax by 60%.
- Over 6 years but less than 7 reduces inheritance tax by 80%.
- Over 7 years will reduce inheritance tax by 100%, meaning no tax will be payable on it.

A subtle but important point on Taper Relief is that the reduction is applied to the inheritance tax payable, not on the actual value of the gift. This means that large gifts, even if tapered have the potential to use up large amounts of your Nil Rate Band.

Example – PETs and Taper Relief

Jennifer gives £500,000 to her son in 2011. She dies 6 years later in 2017. Because she did not survive the gift by more than 7 years, the gift is taken into account in her inheritance tax calculation on her estate. Taper Relief of 80% will apply on the

tax she must pay on the gift because the gift was made over 6 years ago but less than 7.

The gift will 'use up' her entire £325,000 Nil Rate Band and leave £175,000 taxable at the normal rate of 40% (£500,000 - £325,000). The inheritance tax payable will therefore be £70,000 (40% of £175,000).

It is at this point that Taper Relief is applied. In Jennifer's case, the £70,000 will be reduced by 80% so only £14,000 of inheritance tax will be payable on the gift. However, the rest of Jennifer's estate will not be able to benefit from her Nil Rate Band as the gift has used it all.

Do not retain benefits in property you have given away

By retaining a benefit in something you have given away, you risk the possibility that it will still be considered as part of your estate on your death.

The person to whom you have given the property must be able to enjoy it to the 'virtual exclusion' of you (as the person who gave the gift). This does allow you to receive some minor ongoing benefits (for example: still occasionally visiting and staying at a house you have given away) but you must have properly transferred ownership of the asset to someone else.

Make charitable gifts in your Will

If you choose to leave 10% of the net value of your estate to charity in your Will, your estate can benefit from a reduced rate of inheritance tax. Instead of the normal rate of 40%, a lower rate of 36% will be applied instead.

How Roche Legal can help

Dealing with legal issues can be confusing and stressful. We understand this, and we're always on hand to untangle jargon and offer support.

If you need advice on any of the issues raised in this help guide, please don't hesitate to [get in touch](#). Roche Legal is an award-winning legal practice, offering practical and caring advice.

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