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How to plan for inheritance tax

Following the news that thousands more people are expected to pay the standard 40% inheritance tax this year because of the effects of the pandemic, we explore some of the ways to navigate the complexities of inheritance tax.

The complex laws around inheritance tax (IHT) caught many people off guard during the Covid-19 pandemic. Along with the often-sudden loss of a loved one came the issues arising from IHT on gifts passed down to children and grandchildren.

This tax year marks the latest in a series where the number of people being charged IHT on gifts has increased. Since 2009, beneficiaries have paid 40% IHT on estates worth more than £325,000.

Gift your way to less inheritance tax

- There are ways to avoid passing on a large IHT bill to your family, whether it's through gifting or charitable donations:
- You can give away assets or cash worth up to £3,000 a year (known as the annual exemption) with no IHT to pay regardless of the total value of your estate when you die.
- You can give as many gifts of up to £250 to as many people as you want each year – although not to anyone who has already received a gift of your whole £3,000 annual exemption. To make use of this exemption, it's important to keep accurate records.
- If you are married or in a civil partnership, you can pass on your entire estate to your surviving spouse, tax free, when you pass away. Things could become more complicated, however, if your spouse was born in a different country.
- If you give a gift – of any amount – and live for a further seven years after the gift has been given, the beneficiaries will not have to pay any IHT if you pass away after that seven-year period.
- Leaving money to a charity means it's free of IHT and could cut the tax rate on the remaining amount in your estate.

Transferring to a trust or pension

Setting up a trust to transfer some of your estate into for the benefit of your grandchildren is another way to reduce the IHT liability on your assets. However, the trustees could still encounter some income or capital gains tax.

While it may not be the most obvious choice, setting up a pension for your children or grandchildren could be a tax-efficient option. The fund will transfer to them when they turn 18 but they won't be able to access the money until they're much older.

As with anything tax-related, the rules are especially complex when it comes to where your inheritance goes and how much your beneficiaries will end up receiving. That's why it's so important to speak with your financial adviser to review all your options and find the most efficient ways to pass on your wealth.

Inheritance tax facts

Following the Budget in March, it was announced that thresholds will remain the same for IHT until 2026:

- For single people, the threshold is £325,000.
- For those who are married or in a civil partnership, the threshold is £650,000.
- Couples can also pass on their assets (like an owned home) worth up to £1 million in total if they leave it to children or grandchildren.

To learn more about how to make the most of your money this tax year and for more information about inheritance tax and your tax-free allowances, speak to your financial adviser.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen

Key takeaways

- The rise in deaths as a result of the pandemic has meant thousands more IHT payments.
- Following the Budget in March, thresholds will remain the same for IHT until 2026.
- It's a good idea to explore ways to avoid passing on a large IHT bill to your family, such as gifting and charitable donations.