Lifetime Inheritance Tax Planning

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Lifetime Inheritance Tax Planning

Inheritance Tax planning is not just something to consider when making your Will. Careful tax planning during your lifetime can help avoid Inheritance Tax, leaving you with greater assets to provide for those you wish to inherit your estate.

The threshold for Inheritance Tax or 'nil rate band' (NRB) is £325,000*. Upon your death, any assets over the NRB in your estate that do not pass to your spouse or to a charity, or are not covered by other exemptions, will be taxed at 40%. The nil rate band hasn't changed since 2009 and so the rise in house prices over recent years means that many more estates are liable to Inheritance Tax.

In addition, in the case of a husband or wife or civil partners, any unused NRB on the death of the first spouse or civil partner can be transferred for the benefit of the estate of the second. Therefore, if the first to die leaves their entire estate to the surviving spouse or civil partner, then on their death they would have two NRB's totalling £650,000. Also, there is an additional NRB which relates solely to the family home which, if it is passed to a direct descendant, e.g. a child, will increase the total NRB available to a couple to £1,000,000 by the year 2021. There are also further exemptions available for farming and business assets.

Annual exemption

Each tax year, an individual can gift cash or other assets up to £3,000 without any risk of Inheritance Tax becoming payable. This can apply to one gift of £3,000 or several gifts made in the same tax year added together up to a maximum £3,000. The Annual Exemption is personal to the donor, not the recipient - so you cannot give away several gifts of £3,000 to various recipients in the same tax year as you only have one Annual Exemption to set against the gifts.

If the Annual Exemption for the previous tax year has not been used, then any surplus can be carried forward to the next year, but no further. The Annual Exemption cannot be carried back to previous years. If the value of the gift or gifts exceeds the limit, the excess may be chargeable to Inheritance Tax on your death.

*All figures correct 2019/2020

Small gifts

You can make any number of gifts up to £250 provided they are to different people. This exemption cannot be used to cover the first £250 of a larger gift. The gift must be outright and must not exceed £250. This exemption cannot be used in conjunction with the Annual Exemption.

Gifts in consideration of marriage or civil partnership

Gifts in consideration of marriage or civil partnership are exempt up to certain limits, depending on the relationship between you and the parties to the marriage or civil partnership. The limits are:

- £5,000 if you are the parent to one of the parties
- £2,500 if you are the grandparent or remote ancestor to one of the parties
- £1,000 in any other case

Exempt gifts

Gifts to UK charities, certain UK political parties, or gifts for national purposes or public benefit in this country (e.g. to the British Museum or National Trust) are exempt from Inheritance Tax.

Normal expenditure out of income

Gifts made from your surplus income can be exempt from Inheritance Tax in certain circumstances. The exemption applies where the gifts are unconditional, and you can show that the gifts:

- formed part of your usual expenditure (gifts made regularly over a number of years)
- were made out of income
- left you with sufficient income to maintain your normal standard of living

The amount of the gift is an important factor. Gifts over several years must be comparable in size. In establishing the pattern of gifting, you must make gifts to a class of persons, such as children or grandchildren, at particular occasions. A one-off payment, even if it was made out of income, will not be exempt.

Potentially exempt transfers

If you give assets away and one of the exemptions above does not apply, the gift may still be exempt if you survive for seven years or more. If you die within seven years of the date of making the gift, then the value of the gift is brought back into your estate and added to the assets you hold at death. Inheritance Tax will be calculated on the combined total. Taper Relief does not apply unless the gift was very large, ie over the nil rate band threshold.

Life policies written in Trust

Life Policies can be written in Trust and may fall outside your estate for Inheritance Tax purposes.

Existing policies can be written in Trust but wherever possible it is better to create the Trust at the time of purchase. Existing policies may have a surrender value and, by writing a policy in Trust, you give up the surrender value to your beneficiary. This is treated as a gift for Inheritance Tax purposes. However, surrender values are often small compared to the maturity values of Life Policies and may be covered by the Annual Exemption of £3,000. If the surrender value exceeds the Annual Exemption, it may attract Inheritance Tax after your death.

Once a policy has been written in Trust, any annual premiums paid by you are paid for the benefit of the beneficiary. These premiums are gifts, and may be taxable on your death unless they are covered by one of the exemptions such as Normal Expenditure out of Income, or the Annual Exemption.

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