Making sense of

inheritance tax

COVER excellence AWARDS

Protection Review FINALIST 2014

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Welcome to Drewberry

Drewberry Wealth is a thriving advice business that aims to guide clients through every stage of their financial lives. We have a passionate team of financial planning experts in our London and Brighton offices, each of whom is focused on making a difference for our clients.

Tom Conner
Director

We set out to provide the highest levels of customer service in our industry and have more five-star reviews than virtually any other adviser in the UK. No less than 98% of our clients say they'd be happy to recommend us.

We operate one of the top-rated personal finance websites in the UK and are frequently quoted as experts in our field by the national press.

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Protection Review FINALIST 2014

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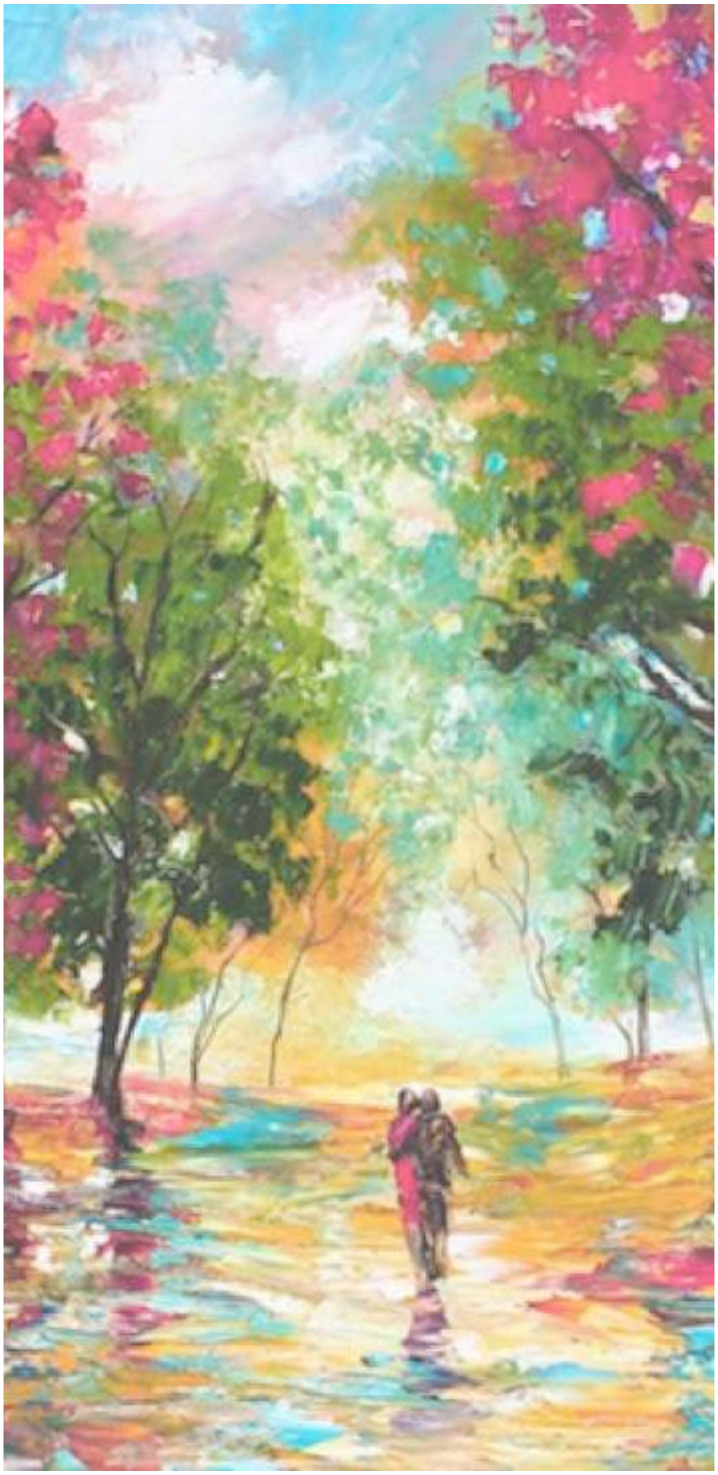

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How Drewberry Wealth can help

At Drewberry Wealth we have experts in all aspects of inheritance tax and estate planning.

Because we analyse your assets alongside your future income needs, your financial ambitions and those of your family, we can create solutions that are tailor-made to your unique needs.

Whatever your circumstances, we'll help ensure that the wealth you worked so hard to create passes to the next generation without attracting a major tax bill.

At Drewberry Wealth we'll position your estate to make the best use of your existing inheritance tax allowances.

This can include:

- Reviewing your Will and 'expression of wish' provisions to ensure that your estate is properly arranged and that the inheritance you plan to leave behind is safe;
- Designing affordable schedules of gift giving;
- Putting proper insurance in place to meet any inheritance tax bills after you're gone;
- Setting up and monitoring any trust arrangements that might be required;
- Advising on a broad range of IHT-exempt investments including business property relief and agricultural assets.

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Things to remember

Few forms of UK taxation attract the level of ire reserved for inheritance tax (IHT).

This probably stems from the fact that it's applied to the assets in your estate after you die – assets that have already been taxed throughout your lifetime.

Worse still, is that it's usually your beneficiaries who end up having to pay the bill. Perhaps worst of all, is that, frequently, the assets you leave to your loved ones end up having to be sold in order to pay the tax bill that's been generated.

Self-inflicted injuries

Doubtless, it's also related to the fact that the majority of inheritance tax bills arise due to poor forward planning.

Ever since it was introduced in its current form in 1986, IHT has been described as 'optional' as there are numerous ways in which potential inheritance tax bills can be mitigated with timely action.

Casting a long shadow

Even so, until relatively recently, inheritance tax was still widely regarded as more a problem for the Downton Abbey set. But this is all changing now.

The prodigious recent growth in UK property prices, at a time when the main inheritance tax allowance (the 'nil-rate band') has been frozen, means that far more Britons are now facing IHT tax bills than ever before. In the 2016 tax year, HMRC collected a record £4.7bn in inheritance tax from more than 40,000 UK families.

In the crosshairs

Most at risk are those in the middle-income bracket who can't afford to make large gifts from their estates and who might even be unaware of how their estate value has crept into the firing line in recent years.

For a quick and painless way to work out if your estate has quietly slipped into the danger zone, try Drewberry's free Inheritance Tax Calculator.

Who's liable to IHT (and who's not)?

In the UK, inheritance tax is charged against any assets that are transferred from your estate to your descendants or other beneficiaries at the time of your death.

All UK residents are subject to inheritance tax on all of their belongings and their assets, wherever they may be in the world.

Inheritance tax is charged at 40% on all the assets in your estate that exceed the current IHT allowance (or 'nil-rate band') of £325,000.

Look a gift horse in the mouth

Remember that IHT can also be charged against any transfers or gifts from your estate up to seven years prior to your death.

Inheritance tax has ensnared far more Britons than ever before, but at the start of the 2017/18 tax year, an additional main residence allowance was also introduced.

Who's exempt from inheritance tax (IHT)?

Spouses & civil partners	There's no IHT liability on transfers between spouses and civil partners although there may be on assets passed between partners that aren't married.
Those making annual gifts	Each year HMRC grants an annual allowance of £3,000 in IHT-free gifts. You can also give a range of small IHT-exempt gifts each year (see p14).
Those invested in IHT-exempt assets	IHT-exempt assets include agricultural and woodland property and heritage assets. Certain types of company share, including the majority of AIM-listed stocks, can also claim exemption via business property relief (BPR).
Britons domiciled abroad	For Britons domiciled overseas, IHT is only due on UK assets such as British properties or bank accounts. Their foreign assets are excluded.

The main inheritance tax allowances

The new main residence nil-rate band (MRNRB)	
As from	Amount
2017/18 tax year	£100,000
2018/19 tax year	£125,000
2019/20 tax year	£150,000
2020/21 tax year	£175,000
2021/22 tax year	Rises in line with CPI

The nil-rate band allowance

The current IHT allowance, or 'nil-rate band', was introduced in the 2009/10 tax year and will remain frozen at £325,000 until the end of 2020/21 tax year.

In the meantime, inheritance tax will be charged at a rate of 40% on all the assets in an estate that exceed this threshold.

The new main residence allowance

From the start of the 2017/18 tax year, Britons have also received an additional nil-rate band allowance of £100,000. This can only be used against the main residence in an estate and only when it's passed to children (including adopted, foster or step children), grandchildren or into the joint names of the deceased's child and their spouse.

The main residence nil-rate band (MRNRB) is scheduled to rise in the coming years so that, by the start of the 2020/21 tax year, it reaches £175,000. This means that, by then, combining the nil-rate band and main residence allowances will give married couples a joint inheritance tax allowance of £1m.

In other words, the first £1m of a married couple's estate will be exempt from inheritance tax, so long as they leave their home to one of their descendants.

The gift allowances

You can also make a wide range of IHT-free gifts each year alongside your annual gift allowance of £3,000 (see p14 & p15).

How the new main residence allowance works

The small print

The new main residence allowance:

- Will reduce by £1 for every £2 that your estate exceeds £2m. This means that estates worth more than £2.35m in the 2017 tax year will lose this allowance altogether;
- Can only be applied to one residence – you'll need to nominate a specific property if you own more than one;
- Can't be used for properties that were never a residence, such as buy-to-lets or commercial properties;
- Will remain available even when a family home's been sold, so long as the assets that replace it form part of the estate that's passed to their descendants;
- Can be inherited by a spouse or civil partner, even in cases where their partner may have died many years before its introduction in the 2017/18 tax year.

You can tot up your family's current IHT exposure by using Drewberry's free [Inheritance Tax Calculator](). It's the first online tool in the UK that also includes the new main residence allowance.

Passing your inheritance tax allowances

Since the law was changed in 2007, any unused nil-rate band allowance at the time of your death can be transferred to your spouse or civil partner.

As there's no IHT liability between married couples or civil partners, if the first partner to depart leaves their entire estate to the other, then 100% of their nil-rate band (NRB) and their main residence allowances will also pass to the surviving spouse.

Important note:
Although you may have more than one late spouse from whom you can inherit unused nil-rate band (NRB), the maximum allowable is equal to twice the standard level of NRB.

Even so, passing assets to your spouse won't necessarily shield those assets from inheritance tax. They will inevitably count against your spouse's nil-rate band when they die (although they can make use of any unused allowances you may have left them).

All things in proportion

In cases where a deceased spouse uses some of their nil-rate band or main residence allowance when they die, then any remaining allowance of theirs is passed to their spouse when they die.

Important note:
Remember, it's the percentage of any remaining allowance that's passed – not its cash value at the time of death.

This is because both the nil-rate band and main residence allowances will change over time.

This means that if a husband dies and leaves half of his nil-rate band or main residence allowance to his widow, her estate will qualify for 50% of the nil-rate bands that are in force at the time of her death, not his.

- For an illustration of how unused nil-rate band is passed between spouses see page 26.
- For an illustration of how unused main residence allowance is passed between spouses see page 27.

Pensions: your IHT secret weapon

The introduction of the new 'pension freedoms' at the start of the 2015 tax year thrust pensions into the spotlight as one of the best ways in which to pass assets to your beneficiaries without attracting inheritance tax.

Death of the 'death tax'

Pensions have always been IHT free as they're held in trust outside of your estate. But the new freedoms removed the punitive 55% 'death tax' on pension assets that were passed after benefits were in payment or if you died over the age of 75.

This reversed the direction of the tide. Where previously it made sense, from an estate-planning perspective, to limit the assets held in a pension, your pension is now one of the most tax-efficient ways in which to pass your wealth to your loved ones.

A whole new ball game

Since April of 2015, if you die before reaching age 75 any pension wealth may be passed tax free – either as income or a lump sum – to your chosen beneficiaries.

If you die older than 75, your beneficiaries will pay tax on any cash they take at their marginal rate (or they can just keep it invested until they need it).

Work out how much your pension will be worth, how long it will last and what might be left for your family with Drewberry's Pension Pot Calculator.

Pensions: your IHT secret weapon

Pensions and IHT

The lifetime allowance for pension assets is currently set at £1 million. This means that a married couple could leave up to £2 million to their beneficiaries without incurring any additional tax.

Potentially, they could leave far more if either had previously applied for protection of their lifetime pension allowance. The lifetime allowance was as high as £1.8m as recently as 2010. Since then, the government has taken a number of swipes at the lifetime allowance but each time it has offered those with larger pension funds the opportunity to protect their previous, higher lifetime allowance.

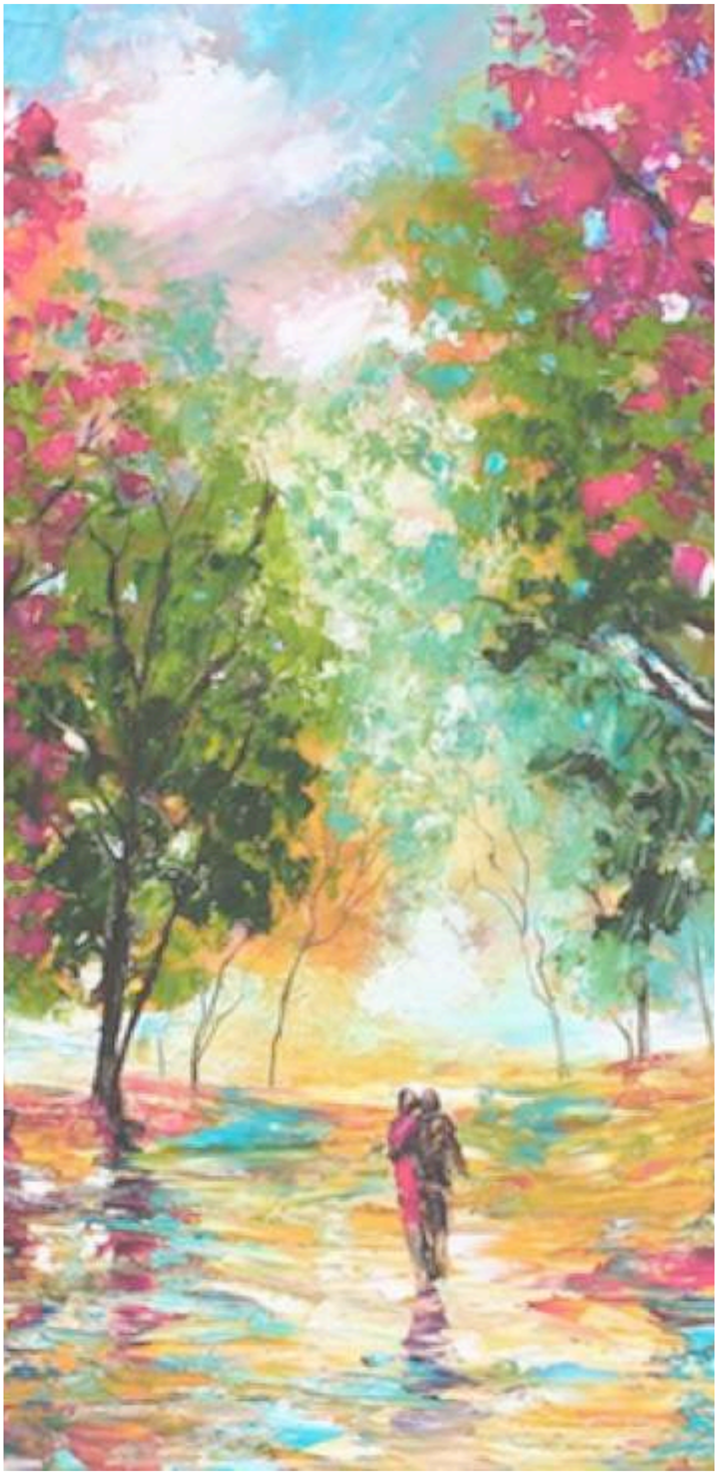
Your pension and your health

If you're planning to make use of your pension to pass assets to your chosen beneficiaries, it's important to act while you're still in good health. This is because HMRC can choose to impose inheritance tax on any pension contributions made while in ill health or two years prior to your death.

Naming your beneficiaries

It's crucial that you complete an Expression of Wish form for your pension that names your beneficiaries. It can be changed at any time and, technically, it's not legally binding, but it gives an important indication of your wishes.

Important note:
If your pension provider doesn't know who to pay the benefits to after you die, it could pay them to your estate. This would make them liable to inheritance tax (and possibly other pension tax charges).



Planning
to succeed

Ways to reduce your inheritance tax bill

Making gifts from your estate

(gifts inter vivos)

How taper relief on gifts works	
Years between gift & death of donor	IHT tax applied
< 3 years	40%
3 to 4 years	32%
4 to 5 years	24%
5 to 6 years	16%
6 to 7 years	8%
7 years or more	0%

Gifts 'inter vivos' are simply gifts that you make from your estate during your life. If your estate is likely to attract an inheritance tax bill, you can reduce its size by making such gifts to your friends and loved ones.

A gift is anything from cash, shares and funds to real estate, jewellery, or family heirlooms.

The seven-year itch

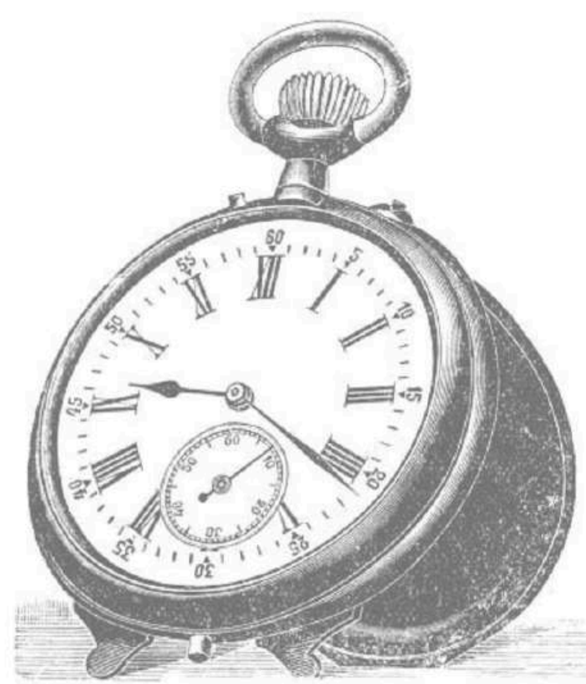
Any gift will become what's known as a 'potentially exempt transfer' (PET) as it will count against your nil-rate band allowance for a full seven years.

This means that if you fail to live this long after making a gift, it becomes a failed PET. The recipient of the gift will then be presented with an IHT bill.

The extent of this bill will depend on just how long you managed to live after making the gift (see below).

Starting the clock on gifts

If you happen to die at any point during the seven years that follow the making of a gift, inheritance tax will be calculated using a sliding scale, called taper relief.



Using your annual gift allowances

HMRC grants every UK resident an annual gift exemption of £3,000 as well as allowing for a wide range of other exempt gifts. You can also make as many small gifts of up to £250, to as many people as you like.

But remember, you can't use your annual exemption and your small gift exemption on the same person in the same year.

Gifts that are included within the table below are immediately exempt from inheritance tax.

Gifts exempted from inheritance tax (lifetime exemptions)

The married couples' exemption

There is no IHT liability between husband and wife or civil partners. You can literally give as much as you like, when you like, to your partner – so long as they're permanent UK residents. However, keep in mind that any assets you pass to them will ultimately count against their nil-rate band allowance when the time comes.

The annual exemption

The annual exemption allows anyone to gift up to £3,000 in each tax year (6 April to 5 April) to whomever they choose. Such gifts aren't added to the value of your estate. Once you've used your annual limit, any unused allowance from the previous tax year can also be put to use.

Gifts worth less than £250

There's no limit to the number of gifts valued at £250 or less that you can make in any tax year. You can give such gifts to as many people as you want – but obviously not to someone who's already received your entire £3,000 annual exemption.

Important note:

You can carry over up to £3,000 in unused gift allowance from the last tax year, but you must use up all of your allowance in the current tax year first. This prevents gift allowance accumulation.

Wedding Gifts

The IHT liability on wedding gifts depends on your relationship to the recipient.

Gifts to your children or stepchildren:

Carry no IHT liability up to a limit of £5,000.

Gifts to your grandchildren & great grandchildren:

Carry no IHT liability up to a limit of £2,500.

Gifts to other relatives or friends:

Carry no IHT liability up to a limit of £1,000.

Gifts to help with living costs

Any gifts made to help pay the living costs of a former spouse, an elderly dependent or a child under 18 or still in full-time education are free from IHT liability.

Gifts from your surplus income

In essence, so long as you have sufficient income to maintain your standard of living, whatever's left can be used to make IHT-free gifts.

Such gifts must be regular and you must keep accurate records of all such giving. With clever planning, such gifts can cover anything from Christmas presents to regular savings plan contributions, insurance premiums or even your children's rent.

Gifts to charities

Gifts to registered charities, museums, universities or community amateur sports clubs are all exempt from IHT.

If you choose to gift more than 10% of your estate to charity, IHT on your remaining estate will be reduced to 36%.

Gifts to political parties

You can give an inheritance tax-free gift to a political party under certain conditions.

Pre-funding your inheritance tax bill

Protecting your loved ones

You can reduce the size of your estate by gifting away assets. This will reduce your potential liability to inheritance tax.

However, larger estates that may be difficult to reduce via gifting, or which might include significant investments that are outside of the pension regime, will usually benefit from additional funding.

In most cases, the most efficient way to accomplish this will be to take out life cover.

Keep your cover in trust

The proceeds of the cover are held in trust and so outside of your estate for IHT purposes.

In this way, a whole of life policy can be employed to provide a tax-free lump sum on death that can be used to pay off any outstanding IHT liability that attaches to your estate.

This is still the easiest way in which to protect a valuable family home from the risk of disposal in order to pay off the tax bill its transfer has created.

- For an illustration of how whole of life cover can be harnessed to pay off any outstanding inheritance tax on your estate, see p28.

Protecting your gifts from inheritance tax

Even if you successfully gift away the balance of your estate, you'll still have created a potential IHT liability for your beneficiaries if you fail to live the requisite seven years demanded by HMRC.

In these situations, a decreasing-term life insurance policy where the sum assured declines in line with the taper relief available to potentially exempt transfers (see p13) will provide the best means to protect your beneficiaries from a tax bill down the road.

This type of cover is referred to as 'gift inter vivos' insurance.

Gift inter vivos policies

There are a number of things to keep in mind with gift inter vivos policies:

- They offer a sum assured that decreases in line with the inheritance tax liability on a gift as the years go by;
- Such policies are always written for a term of seven years as any IHT liability on a gift ceases at this point;
- As the cover reduces in line with the IHT liability, gift inter vivos policies are very cost effective as the assured only ever pay for the level of benefit they need;
- By writing such policies in trust they won't form part of your estate on death so the proceeds won't attract inheritance tax (IHT). The payout can then be used to pay any IHT bills that might attach to your estate within the required six months.
- For an illustration of how gift inter vivos policies work in practice, see p29.

You can work out how making gifts of one kind or another from your estate will reduce your family's inheritance tax exposure by using the Drewberry Inheritance Tax Calculator.

Investing in inheritance tax-exempt assets

Thanks to the efforts of various governments to help protect owner-operated businesses, estates and farms from potentially ruinous 'death duties', there are four main types of asset that have retained at least partial exemption from inheritance tax.

These are business assets, agricultural property, woodlands and heritage assets.

Business property relief

Business property relief (BPR) is one of the most valuable exemptions from inheritance tax as it acts to protect business owners from IHT on their business assets.

Importantly, it extends to include the ownership of shares in any unlisted company.

It also offers partial relief for those who own majority rights in listed companies, land, buildings or business machinery or who have such assets held in a trust.

Happily, small companies listed on the AIM market have always been regarded as 'unlisted' for the purposes of inheritance tax.

This means that, in theory at least, holdings in AIM-listed companies will be exempt from IHT so long as they've been owned for the requisite two years (see overleaf).

Assets that can be exempt to inheritance tax

Agricultural property

A farm may not attract IHT, but agricultural property relief (APR) only attaches to its ‘agricultural value’. IHT can still apply to farm assets like agricultural machinery. There’s no guarantee that buildings or land located on farmland will qualify for APR. In most cases, HMRC will examine how the property is used before granting this relief.

Business assets

Business property relief (BPR) can be used to exempt shares in unlisted companies from IHT. It can also offer partial relief for those with majority rights in listed companies, land, buildings or business machinery or who have such assets held in a trust. Such assets must be held for a minimum of two years.

AIM-listed stocks

Thanks to business property relief (BPR), numerous AIM-listed shares held directly (ie not in a fund) for a period of two years could potentially escape IHT. But not every AIM stock meets the criteria for BPR. Even so, it’s estimated that around three quarters of the 1,000 or so companies listed on AIM qualify for either full or partial relief.

Woodland property

Woodlands themselves aren’t subject to IHT but the proceeds from any timber sales will be. The value of any woodland will also need to be included in your estate – even though it’s ignored for IHT purposes.

Heritage assets

Relief from IHT can be claimed by those families who leave behind buildings, land or objects of “national scientific, historic or artistic importance”. Not surprisingly, a number of criteria need to be met in order to qualify for this relief.

The IHT-free ISA

Thanks to a useful rule change back in 2013, AIM-listed stocks can now be held in an ISA.

This means that those with substantial ISA savings or other liquid assets can consider converting them into IHT-free ISAs.

The rules for business property relief (BPR) mean that the majority of AIM-listed stocks qualify for exemption from IHT. For those who can shoulder the additional investment risk and management charges that accompany investment in the AIM market, this is an opportunity to escape the 40% IHT charge on their ISA savings altogether.

Minimum holding period

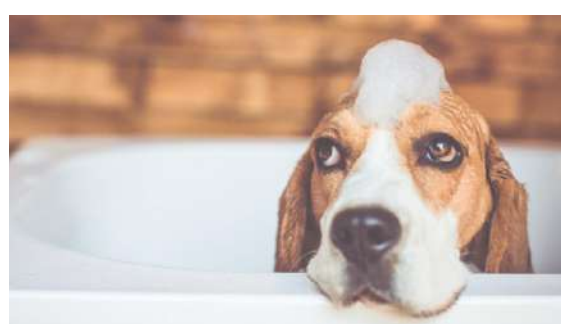
Investors need to hold AIM shares directly for at least two years in order for them to qualify for exemption from inheritance tax.

Don't let the tail wag the dog...

Although the AIM market has grown in size and maturity, it's important to recognise the added risks that accompany investment into AIM stocks.

The old adage that you shouldn't invest purely on the strength of a tax break is well worth remembering here.

This is because any tax relief extended by one government can quickly be retracted by another.



Moreover, AIM stocks don't automatically qualify for business property relief.

The IHT-free ISA

Qualifying for BPR

In general, companies that own 'excepted' assets ie assets that aren't used for the purposes of the trade, won't qualify for business property relief.

This means that companies that deal in securities, stocks and shares, land or commercial buildings or which are dedicated to making or holding investments are likely to be barred from the relief.

Dual risks

Companies can also exempt themselves in the course of their business. For example, a growing company may decide to raise capital by pursuing a joint listing on another market. While perfectly legitimate, this will automatically disqualify it for business property relief in the UK.

Thrills and spills...

There's also the risk that a volatile portfolio of AIM shares could, potentially, incur losses in excess of any inheritance tax savings.

Dividend payouts among AIM stocks also tend to be sparse, which increases their volatility.

All this means that most investors with inheritance tax worries will be better served by finding a dedicated AIM manager to run their portfolio.

Leave it to the pros

There are a number of professional portfolio managers who specialise in AIM-listed stocks and who today run IHT-free ISAs. These benefit from professional investment research and analysis – much of which is dedicated to monitoring portfolio holdings from a business property relief perspective.

Although the risks and the charges may be higher than conventional stock market investment, for many investors with substantial ISA portfolios these potential risks will stack up well against the potential for a 40% hit from inheritance tax.

Making use of trusts

Since the rules were changed to allow married couples and civil partnerships to pass any unused nil-rate band allowances to one another on death, the benefits of using trusts to protect the assets in an estate from inheritance tax have declined.

Even so, they still offer a number of attractions to those with larger estates to manage.

Taking control

Trusts can come into play for those with valuable homes or extensive assets that they want to pass down through their family over coming generations.

Trusts have a particular appeal as they also grant donors greater control over where their money goes.

PROS	CONS
Trusts can protect your assets from the impact of divorce – either your own or that of your children.	Trusts can be expensive. They generally require professional advice and planning as well as regular review.
Trusts can also protect your assets from the bankruptcy of your beneficiaries or other recklessness.	Trusts are complex and their tax treatment will differ depending on the circumstances. The assets in a trust will need to be re-assessed every 10 years for valuation purposes.

Using trusts: the pros and cons

PROS	CONS
Some specialist trusts such as disabled persons' trusts, bereaved minor trusts or 18-25 trusts still retain the nil-rate band and main residence allowances as they pass an 'absolute interest' or 'interest in possession' to the family's children or grandchildren.	Generally, trusts don't offer an immediate exemption to IHT. Assets gifted (or settled) into trusts will still be considered as potentially exempt transfers (PETs).
	Often an immediate tax charge will apply to a trust if it receives an excessively large gift.
	Using a trust to shelter a family home could mean that you lose your entire main residence allowance.

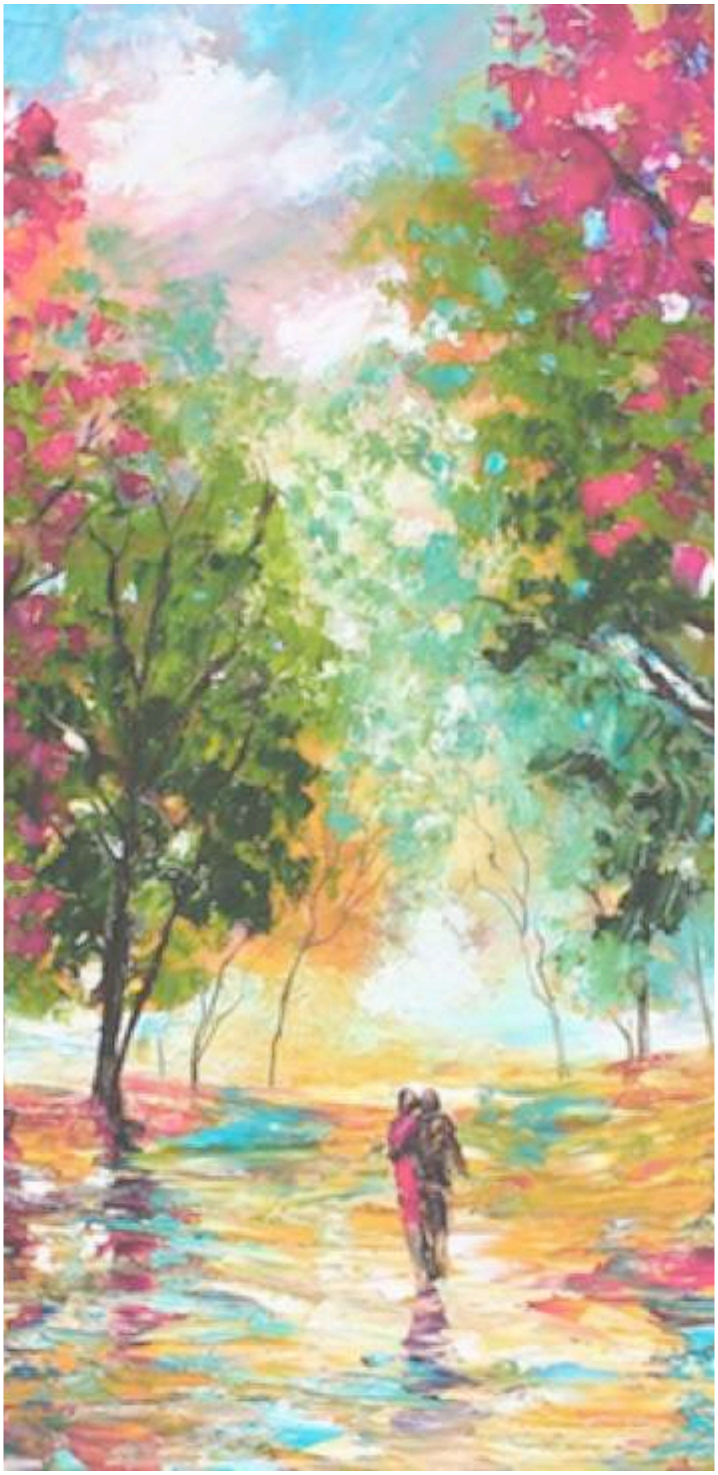
Ask a professional

"All this means that for most people, finding a qualified professional adviser who can help identify the most suitable trust arrangement and ensure that the trust is properly administered is a must."

Peter Banks
Head of Investment & Tax Planning
E. peter.banks@drewberry.co.uk
T. 0208 432 7333

Making use of trusts…

The most common trust arrangements	
Bare (absolute) gift trusts	Are generally set up for children who, usually at age 18, receive the full entitlement to the trust's assets. The beneficiaries are named at outset and can't subsequently be changed.
Discretionary trusts	Enable donors to retain control over who the beneficiaries might be, the extent of the benefits and when they'll be paid out.
Loan trusts	Allow money to be lent to a trust rather than gifted, so the donor retains access to their money. Although such loans are subject to IHT, the growth is IHT free.
Discounted gift trusts	Allow donors to gift away assets, but to still draw an income from them for the remainder of their life. Even if the donor dies within seven years of creating the trust, it's still likely to deliver tax saving in most scenarios.



Planning
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Illustrations

Passing unused nil-rate band between spouses

Imagine Mary dies at the start of the 2017/18 tax year, having left assets totalling £108,333 to her two children from a previous marriage and the remainder of her estate to her husband, Ken.

She will have used one third of her nil-rate band allowance of £325,000 and the remaining two thirds (66%) will be passed to her husband, Ken.

Fast forward

Let's imagine that Ken then lives for another 10 years, before dying in 2027, when the nil-rate band has risen to £420,000.

By now, the unused two thirds of his late wife's allowance will be worth £280,000 (ie £420,000 x 66%), not the £216,666 that was notionally left unused at the time of her death.

This means that Ken now has a total IHT allowance of £700,000 (ie £420,000 + £280,000). If his wife had passed 100% of her nil-rate band his total allowance would be £840,000.

These rules apply to anyone whose partner has died since 12 November 1974.

Take control:

Work out if your family is heading toward a nasty inheritance tax bill with Drewberry's unique Inheritance Tax Calculator.

Passing unused main residence allowance between spouses

Imagine Nigel, a father of three, dies in the summer of 2020, when the main residence allowance will be £175,000 and that he, and his wife Margaret, want to leave their £450,000 home to their three children.

Thinking ahead

Rather than gift his half of the family home to his children, Nigel opts to protect the couple's IHT allowance and leaves his whole estate to Margaret.

This means that Margaret also inherits 100% of her husband's main residence and nil-rate band allowance.

If Margaret dies 10 years later in 2030, when the family's home is now worth £600,000, there won't be any IHT to pay.

This is because, by then, Margaret's main residence allowance will be worth the £175,000 it reached in the 2020/21 tax year plus the value of the 10 years of CPI-linked increases between then and her death. Nigel's main residence allowance (which was passed to Margaret) will be worth the same.

Any remaining IHT liability can be offset against Margaret's nil-rate band allowance and the 100% of Nigel's nil-rate band that she was passed.

Don't get lost:

Our free to use Inheritance Tax Calculator will show you the best way to avoid leaving a painful IHT bill for your loved ones.

Pre-funding inheritance tax bills with whole of life cover

Thanks to a long and successful career and a wealthy first husband – Harry, who died in 1995 – Pamela, 66, has amassed a significant £1.8m estate.

Pamela's been married to Tom, 71, for the last 10 years and, between them, they have an estate valued at £2.6m, which includes a £1.2m home. Let's assume that they have separate Wills, which leave their assets to their four grown-up children.

Avoiding hefty bills...

All this means that if Tom dies in the 2017/18 tax year, after subtracting his nil-rate band and main residence allowances, his estate will be liable to an IHT bill of £150,000.

If Pamela dies in the 2017/18 tax year her estate will attract an IHT bill of £380,000 (remember she also inherited an additional nil-rate band and main residence allowance from her late husband, Harry).

To meet these liabilities, the couple can choose to insure themselves for these amounts with individual whole of life policies that are written into trust. Because they will pay the premiums from their surplus income, the premiums will also escape subsequent inheritance tax.

The cost of cover

Because insurers will quote a wide range of premiums, it's worth making use of an adviser like Drewberry that can compare pricing from across the whole market to find the best deal on such life insurance cover.

Protecting gifts from inheritance tax

This time, let's imagine that Pamela and Tom decide to reduce the size of their £2.6m estate by gifting £1.2m to their four grown-up children in Pamela's name.

Sharing the wealth

Pamela's children will each receive £350,000 and Tom's will receive £250,000, reflecting the assets left by Pamela's first husband, Harry.

Pamela's gift will count as a potentially exempt transfer (PET), which means that, should she die within seven years of making the gift, her beneficiaries will be presented with an IHT bill.

With the additional nil-rate band and main residence allowances she inherited from Harry, Pamela's gift will initially be subject to a £140,000 IHT bill.

This will reduce to zero by the end of seven years when the IHT liability finally expires (as in the table).

How taper relief on gifts works

Years between gift & Pamela's death	IHT due	Sum assured
< 3 years	40%	£140,000
3 to 4 years	32%	£112,000
4 to 5 years	24%	£84,000
5 to 6 years	16%	£56,000
6 to 7 years	8%	£28,000
7 years +	0%	£0

Drewberry Wealth regularly updates all of its ‘Making Sense…’ guides to ensure that we offer only the most up-to-date information available. We’ve taken every care to ensure that this information is correct and in accordance with our understanding of the law and HM Revenue & Customs practice, at the date of publication: 12 June 2017.

The information contained in this guide does not constitute advice and Drewberry Wealth accepts no liability for any use you may choose to make of it. We always recommend that readers seek professional advice before taking any major financial decision.

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