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Navigating the complexities of inheritance

Should you consider estate planning and gifting for future generations?

As we age or accumulate more wealth, protecting and preserving our assets for future generations becomes increasingly essential. This process, known as Inheritance Tax (IHT) planning, estate planning or intergenerational wealth planning, involves strategically managing your estate to minimise tax liabilities and ensure that your wealth is passed down to your loved ones in the most tax-efficient manner possible.

Effective planning can significantly impact the financial wellbeing of your heirs, making it crucial to consider various strategies and tools available for safeguarding your estate.

One common question we receive from clients is whether to gift assets during their lifetime or wait until they have passed away. The answer is more complex and heavily depends on your personal and financial circumstances and objectives. Gifting can provide immediate support to family members and potentially reduce your estate's size, lowering the IHT burden.

However, careful consideration must be given to the gifts' timing, amount and recipients to ensure that they align with your long-term goals and comply with tax regulations. Understanding these nuances is essential in making informed decisions that will benefit you and your loved ones.

UNDERSTANDING INHERITANCE TAX

When you pass away, IHT is potentially payable to HM Revenue & Customs (HMRC). The amount due depends on the estate's value minus any debts and after all available thresholds have been used. These thresholds are the nil rate band (NRB) and the residence nil rate band (RNRB). At a high level, the NRB is £325,000, and the RNRB is £175,000, the latter of which is only available if you leave your home to a direct descendant. The standard rate of IHT due to HMRC on amounts over these thresholds is 40%. This reduces to 36% if at least 10% of your net estate is left to charity.

WHY DO WE GIFT?

We gift for two common reasons: We want to help our family and loved ones now, when they need it, and whilst we can see them enjoy it, as opposed to when we have passed away. This is often called a 'living inheritance'. Additionally, we may have a large estate and wish to reduce its value so that our beneficiaries pay less or no IHT when we pass away.

HOW MUCH CAN YOU GIFT?

In short, you can gift away however much you want to whoever you like and whenever you like. If these gifts fall within the 'annual gift allowances' or are made from your regular surplus income, they automatically fall outside your estate for IHT tax purposes. Otherwise, you must survive seven years after making the gift before the gift is excluded from IHT tax calculations.

THE IMPACT OF SEQUENCING GIFTS

The sequencing of gifts can significantly impact the wealth you want to pass on. In addition to the seven-year rule, there is the less well-known 14-year rule. Giving a gift outright to an individual and/or Absolute/Bare Trust in excess of the annual allowances is known as making 'Potentially Exempt Transfers' or PETs.

POTENTIALLY EXEMPT TRANSFERS AND THEIR USES

For example, a common reason for making a PET might be to help a child onto the property ladder. To ensure the gift is outside of your estate for IHT tax purposes, you need to survive seven years from when the gift is made. If the PET is more than the NRB (£325,000), there is gradual tapering on the excess once you have survived for over 3 years. The longer you survive after making the gift (between 3 and 7 years), the greater the tapering.

CHARGEABLE LIFETIME TRANSFERS

Should you settle any money into a relevant property trust, such as a Discretionary Trust, these gifts are known as 'Chargeable Lifetime Transfers' or CLTs. An example of such a settlement might be grandparents wanting to pass money down to their grandchildren. A common reason for this may be that their children already have a large estate, so if they were to inherit any more, it would be unhelpful for their IHT position.

COMPLICATIONS IN GIFT ORDER

Complications may arise when an individual has passed away and has made both PETs and CLTs. This is because the order of these gifts can result in bringing 14 years' worth of gifts into the IHT calculation. When considering which gifts are liable to IHT, the gifts are placed in the order they were made, starting with the oldest and moving towards the date of death.

HMRC RULES ON FAILED PETS

HMRC rules are such that any CLTs made in the seven years before any 'failed PETs' must also be

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brought into account. If an individual makes a PET and dies within 6 years and 11 months, the PET fails. From the 'failed PET' date, HMRC will look back a further seven years and include any CLTs in their calculation to determine the IHT due on the PET.

ANNUAL GIFTING ALLOWANCES

Under current legislation, everyone can gift away £3,000 per year. This is called your 'annual exemption'. Any unused allowance can be carried forward to the following tax year; however, it cannot be carried over again. There is also a wedding allowance of varying amounts depending on the relation, which must be made before the wedding, and the wedding must happen: £5,000 to a child, £2,500 to a grandchild, £1,000 to a relative or friend. Wedding gifts can be combined in the same year with the annual exemption.

SMALL GIFTS ALLOWANCE

You can also make gifts of up to £250 to as many different people as you like, as long as the person has received more than £250 from you that tax year. ■

DO YOU REQUIRE INFORMATION OR PERSONALISED ADVICE ON GIFTING AND INHERITANCE TAX PLANNING?

For those seeking further information or personalised advice on gifting and Inheritance Tax planning, please do not hesitate to contact us for expert guidance tailored to your specific circumstances.

THIS ARTICLE DOES NOT CONSTITUTE TAX, LEGAL, OR FINANCIAL ADVICE AND SHOULD NOT BE RELIED UPON AS SUCH. TAX TREATMENT DEPENDS ON THE INDIVIDUAL CIRCUMSTANCES OF EACH CLIENT AND MAY BE SUBJECT TO CHANGE IN THE FUTURE. FOR GUIDANCE, SEEK PROFESSIONAL ADVICE.

THE FINANCIAL CONDUCT AUTHORITY DOESN'T REGULATE TRUST PLANNING AND MOST FORMS OF INHERITANCE TAX (IHT) PLANNING. SOME IHT PLANNING SOLUTIONS PUT YOUR MONEY AT RISK, AND YOU MAY GET BACK LESS THAN YOU INVESTED. IHT THRESHOLDS DEPEND ON INDIVIDUAL CIRCUMSTANCES AND THE LAW. TAX AND IHT RULES MAY CHANGE IN THE FUTURE.