Guide to Inheritance Tax

Leaving money to your family?
Don’t leave them with a chunky bill to pay.

The basics

If you leave money, property, works of art, or pretty much anything that’s worth something, to your relatives when you die, there is a chance that they will have to pay inheritance tax on that legacy. Once seen as a tax only for the wealthy, the housing boom has seen more and more people fall into the inheritance tax net.

At its most basic, it is payable on all estates worth more than £325,000 (2018/19 tax year). It is payable at 40%, charged on the amount over and above the threshold. So far so easy, but there are all sorts of exceptions.

So for example, if you as a single person leave behind assets to kids worth £500,000 (assuming you only have one property), your estate pays nothing on the first £450,000, and 40% on the remaining £50,000 – that’s a total of £20,000 in tax – assuming you’re not leaving anything to charity.

Don’t think you can give all your property away on your death bed. HMRC is wise to this. You can give assets away, but then have to survive a full seven years for them to fall out of your estate. That said, there are limits: anything considered a ‘normal gift out of income’ (i.e not your house) is exempt, and anything up to £3,000 a year. So if you’re a youthful grandparent, generously minded and you can afford to, you might want to get gifting!

It’s not a straightforward area. And if you’re not married (this all gets very 19th century here) do read up on what this means – it depends on whether you own the property as joint tenants or tenants in common and whether you have a will.

The nitty gritty

1. You can pass on any assets to your spouse or civil partner free from inheritance tax.

2. If you pass on the family home to your near-relatives (in practice, children and grandchildren), you get an extra inheritance tax-free allowance of £125,000 (for 2018/19). This will progressively rise to £175,000 by 2020/21.

3. This means that the maximum couples (either married or in a civil partnership) can pass on to kids tax-free today is £900,000 (That’s £325,000 plus the £125,000 allowance for a property x 2). When the first person in a couple dies, their allowance is passed on to the survivor.

4. This will rise to a combined total of £1 million (including your home) per couple by 2020 if you’re leaving it to kids, step-children and grandchildren. (That’s £325,00 plus property allowance of £175,000 per person x 2).

5. Your children will pay 40% tax on anything above this. If your property is worth more than £2 million you start to kiss goodbye to that extra allowance i.e. pay more tax.

6. You don't pay inheritance tax on money given to charities.

7. Business owners can claim ‘business relief’ when passing on their businesses.

Updated April 2018

What counts as assets?

It's not just cash, pretty much everything forms part of an estate for inheritance tax – a house, a buy-to-let property, shares, ISAs, precious jewellery, antiques and so on. The one thing that doesn't count is a pension. Pensions in drawdown (not annuities in most cases) can be passed on free of tax if the person dies before 75 and at the recipient's marginal rate of tax if after 75.

This makes pensions an interesting financial planning tool to consider.

PENSIONS PROVIDE CERTAIN PROTECTION FROM INHERITANCE TAX

Boring Money tips

- Have the conversation if you can bear to – yes, it's uncomfortable, but making sure everyone knows what to expect after you die is arguably sensible. Of course you could argue that it will be least of your worries and we're not here to preach!
- Don't believe that 'it will all take care of itself'. Inheritance tax can take a huge slug of your hard-earned wealth and it only takes a little planning to minimise its worst effects.
- With married couples, if the first dies and leaves everything to the second, the allowance can be passed on and is still available when the second one dies. If you're not married this is a big area where some old-fashioned views make life harder for you and it's worth being clear on what this means.
- Think about making gifts as you get older. Little and often is key! (if you feel so inclined... Of course you could just spend it all!)
- Make a will – giving money in a structured way can make a difference to the inheritance tax bill
- Remember that the inheritance tax bill needs to be paid before probate is granted and the assets of the estate are parcelled out. Your relatives may need to take out a loan to do this.
- If you have assets of over £325,000 or £450,000 including a house, it makes a lot of sense to pay a tax adviser or a financial adviser for a few hours of their time to help you plan and structure things. Our site has tips on how to find a good one. Expect to pay about £150 - £250 an hour. Better than seeing the kids being lumped with a 40% tax bill on stuff which could have been avoided?
- Read up on trusts if you have substantial assets to leave to family.

WE'VE MORE DETAILS ON OUR GIVING GRANDPARENTS PAGES ON OUR WEBSITE

Updated April 2018