



Article

# 6 Ways to Protect Your Family From An IHT Bill

More and more people are getting caught in the inheritance tax (IHT) trap as property values have soared, pushing many estates over the threshold. Only wealthy individuals paid the tax in the past. However, with the £325,000 threshold frozen until at least 2028, more and more people are getting caught in the net.

IHT is an increasingly important source of revenue for HMRC, providing [£7.5bn in the financial year](#) up to March 2024. The current tax-free threshold is [£325,000](#). If the value of your estate is above this when you die, inheritance tax may be due.

The standard rate of 40% is only charged on the part of your estate that's above the threshold. So, if your estate is worth £500,000 and your tax-free threshold is £325,000, then inheritance tax will be 40% on £175,000.

There are legitimate strategies to cut your inheritance tax bill and increase the tax-free amount being passed on to your heirs. Let's take a look at six popular ways to protect your wealth.

## 1. Leave your estate to your spouse

You can pass on assets of unlimited value to your spouse or civil partner, and they won't pay any inheritance tax, even over the £325,000 threshold.

Since the rules changed in 2007, your spouse can also inherit your [unused nil-rate band](#) when you die. This means their allowance could grow up to £650,000 (2 x £325,000). However, the unused allowance is not passed on automatically, so they must make a formal claim to HMRC within two years of your death. If you owned a home together as a couple, the allowance could be as much as £1m.

## 2. Make Gifts

Another simple way to avoid paying inheritance tax is to give your money away during your lifetime. The seven-year rule means no tax is due on any gifts as long as you live seven years after giving them.

You have an 'annual exemption' from [inheritance tax of £3000 in gifts](#), split between however many people you like. In addition, you can make unlimited gifts of up to £250 to others under the small gift allowance, as long as you've not used another allowance on the same person.

What's not so well known is that you can also give gifts from your surplus income. It just needs to be money you can give away regularly without significantly impacting your lifestyle. Cash from a house sale would not be eligible.

You can also give a tax-free gift each year to someone getting married or starting a civil partnership each year. The amount varies depending on your [relationship with the bride and groom](#), e.g. £5000 for your child, £2,500 for your grandchild and £1000 for anyone else.

If you're giving gifts to the same person (e.g. your child), you can combine the wedding gift allowance of £5000 with your £3000 annual exemption, just not the small gift allowance.

Gifts over £3000 and within the seven-year window are known as 'potentially exempt transfers', PETS. Should you not survive the seven years, taper relief is applied. So, if the gift was made 0-3 years

before death, the tax rate is 40 %, 32% for 3-4 years, 24% for 4-5 years, 16% for 5-6 years, 8% for 6-7 years and 0% for seven years or more.

Given these rules, it may be worth starting to give your money away early, but don't leave your spouse vulnerable.

### 3. Leave your property to your children

There's no inheritance tax due if you pass your home to your spouse or partner when you die.

As a homeowner, you get an additional £175,000 allowance known as the nil rate band. This applies if you pass your main property on to family members, increasing [your threshold to £500,000](#). As spouses and civil partners can combine their allowances, the overall allowance can reach £1m (£325,000 + £175,000 x 2). Note, you can only leave the property to "direct descendants" - i.e. children or grandchildren, not nephews, nieces, brothers or sisters.

For estates over £2m, the residence nil-rate band allowance is reduced at a rate of £1 for every [£2 over the threshold](#).

### 4. Pass on your pension pot

Pensions are useful in avoiding or mitigating inheritance tax as they are considered outside your estate. Even if you've already accessed your pension savings, you can pass on the entire pot to your beneficiaries IHT-free.

You're still able to make use of your allowances. So, you could use up your nil-rate band and residence nil-rate band. You could also give away a large sum from your pension nest egg without incurring the 40% inheritance tax rate.

Be aware that your beneficiary may need to pay extra income tax as they draw down on the pension, but only if you die after age 75.

Using your pension in your estate planning also offers flexibility, as you could still access the funds if you needed to go into care.

### 5. Leave money to charity

If you leave money to a UK-registered charity, it will always be free from inheritance tax. Plus, if your bequest is 10% or more of the net value of your estate, inheritance tax for the rest of your estate will only be [due at the reduced rate of £36%](#). This also applies if you leave money to political parties or local sports clubs.

The 10% does only apply to the amount of your estate over the IHT allowance of £325,000.

## 6. Use a life insurance policy

If you can't avoid a hefty inheritance tax bill, consider taking out a life insurance policy. That way, when the tax is due, the charge can be paid out of your policy rather than your beneficiaries paying it from the estate. Bear in mind, however, that the older you are, the more expensive these policies can be.

Make sure the policy is written inside a trust. This keeps it outside your estate, so the payout doesn't increase the estate's value or the amount of inheritance tax due. If you pay the insurance policy premiums yourself, you can include them in your tax-free exemptions.

### Next steps

Inheritance tax can pose a significant threat to your family's financial well-being but by taking proactive steps it's possible to plan ahead. Making gifts, taking advantage of exemptions and considering a life insurance policy will help shield your family from a high tax bill and ensure they inherit the wealth you've worked hard to accumulate.

However, the rules surrounding inheritance tax are complex. So we recommend you seek professional advice. Please contact us if you'd like any help with your estate planning, and we'll recommend the most effective strategies for your situation.

#### **Please note:**

The information contained in this article is for general guidance only and does not constitute personal financial, tax or legal advice. Inheritance tax planning is complex and tax rules, allowances and reliefs are subject to change and depend on individual circumstances.

Inheritance tax planning and estate planning are not regulated by the Financial Conduct Authority. The value of your estate, the effectiveness of planning strategies and any potential tax savings cannot be guaranteed.

Before taking any action, you should seek appropriate professional advice to ensure any strategy is suitable for your personal circumstances. This may include advice from a regulated financial adviser, tax specialist or solicitor.

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