DG FINANCIAL SERVICES LIMITED

INHERITANCE TAX

What families often get wrong and how the rules could affect your estate

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What families often get wrong and how the rules could affect your estate

Gifting can be one of the most personal aspects of estate planning. Many people want to pass on wealth to children, grandchildren or other loved ones while they are still alive, rather than waiting until their estate is distributed after death.

This can be a thoughtful way to support family with house deposits, education costs, savings, investments or day-to-day financial pressure. However, gifts can also create confusion. Many families assume that once money has been given away, it immediately falls outside the estate. In reality, Inheritance Tax rules are more complex.

At DG Financial Services, we help clients understand how gifting fits into their wider estate planning. The right approach should prioritise your financial security first, before considering how wealth can be passed on in a structured and tax-aware way.

UNDERSTANDING HOW INHERITANCE TAX WORKS

Inheritance Tax is typically charged at 40% on the taxable value of an estate exceeding the available tax-free thresholds. For the 2026/27 tax year, the standard nil-rate band (NRB) is £325,000. This has been frozen at £325,000 until 5 April 2030.

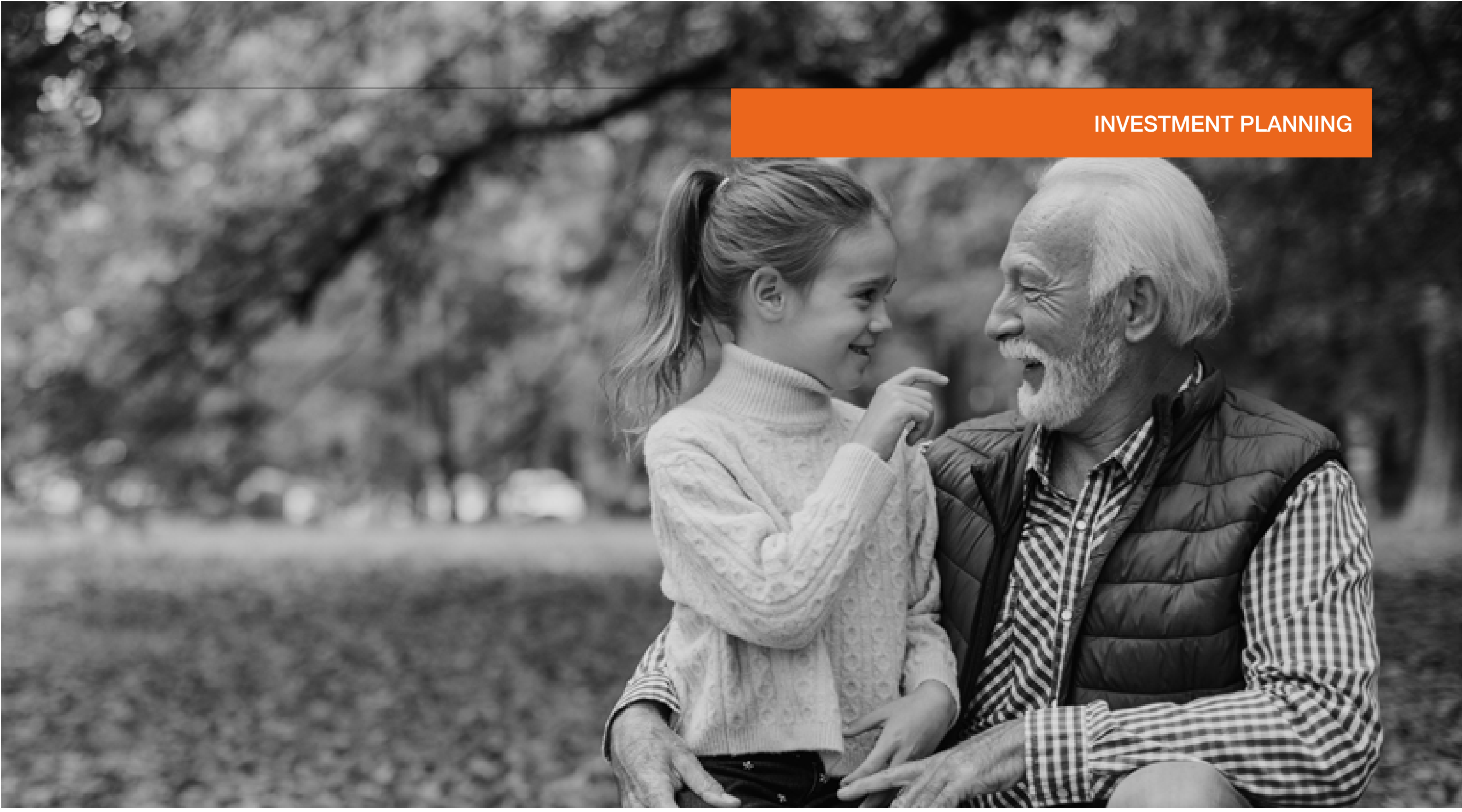
The residence nil-rate band (RNRB) may also be available when a qualifying residential property, or an appropriate share of one, is passed to direct descendants, such as children or grandchildren. The RNRB is currently £175,000 per individual, so where both the standard NRB and the full RNRB are available, an individual may pass on up to £500,000 free of Inheritance Tax.

The RNRB is subject to specific conditions and can be tapered if the net value of an estate exceeds £2 million. The taper generally reduces the available RNRB by £1 for every £2 by which the estate exceeds the £2 million threshold. In some circumstances, a downsizing or disposal of a qualifying residence can also affect the availability of the RNRB.

CALCULATION OF THE TAXABLE ESTATE

For married couples and registered civil partners, unused portions of the NRB and RNRB can generally be transferred to the surviving spouse or civil partner on the second death. Subject to the relevant conditions, this can increase the combined tax-free amount to up to £1 million, although the actual amount available will depend on the allowances used on the first death and the circumstances of the second estate.

The calculation of the taxable estate can also involve more than simply adding up property, savings and investments. Debts and certain liabilities may be deductible, while lifetime gifts, trusts, jointly owned assets, business or



agricultural interests and life assurance arrangements can all affect the eventual IHT position. Gifts made during an individual's lifetime can also remain relevant for IHT purposes, particularly where they fall within the seven-year gifting rules or involve trusts.

Not every estate will qualify for every allowance, and the interplay between the NRB, RNRB, lifetime gifts, exemptions and reliefs can be complex. The treatment of particular assets and beneficiaries therefore needs careful consideration rather than relying solely on the headline £500,000 or £1 million figures.

This is why gifting should not be considered in isolation. An effective estate-planning strategy should sit alongside your will, pensions, property, savings, investments and any plans for later-life care. The objective is not simply to reduce a potential IHT liability, but to balance tax efficiency with control of assets, access to capital and the individual's wider financial and family circumstances.

SEVEN-YEAR RULE IS OFTEN MISUNDERSTOOD

One of the most common misunderstandings about Inheritance Tax concerns the seven-year rule. Many people know that gifts may fall outside the estate if the donor survives for seven years. However, the detail is often overlooked.

A gift made during your lifetime may be treated as a potentially exempt transfer. If you survive seven years from the date of the gift, it usually falls outside your estate for Inheritance Tax purposes. If you die within seven years, the gift may still be considered when calculating Inheritance Tax.

This does not necessarily mean the recipient will pay tax on every gift. The position depends on the size of the gift, other gifts made in the previous seven years, available exemptions and how much of the nil-rate band has already been used.

Taper relief is also commonly misunderstood. It may reduce the tax payable on certain gifts made more than three years before death, but it does not reduce the value of the gift. It is relevant only where gifts exceed the available nil-rate band.

GIFTING ALLOWANCES MANY FAMILIES MISS

Some lifetime gifts can fall immediately outside the estate for Inheritance Tax purposes if a specific exemption applies. This is important because an exempt gift is generally not treated as a potentially exempt transfer (PET) and does not become chargeable simply because the donor dies within seven years.

The annual exemption allows an individual to give away up to £3,000 in each tax year without the gift being taken into account for Inheritance Tax. The £3,000 exemption can be split among multiple recipients and need not be given to a single person. If the full exemption is not used, the unused amount can generally be carried forward for one tax year only. The current year's exemption is used before any carried-forward amount. Any unused carried-forward amount then expires.

The small gifts exemption can apply to gifts of up to £250 per recipient in a tax year. There is no overall limit on the number of recipients, but the exemption cannot normally be used if the same recipient has already benefited from another Inheritance Tax exemption, such as the annual exemption, in respect of the same gift. The £250 limit applies to each individual recipient rather than to the donor's estate as a whole.

OTHER AVAILABLE EXEMPTIONS

Separate exemptions may apply to certain wedding or civil partnership gifts. The permitted amount depends on the relationship between the donor and the recipient: up to £5,000 for a child, £2,500 for a grandchild or great-grandchild, and £1,000 for other individuals. These exemptions are subject to specific conditions and can be used alongside other available exemptions where the requirements are met.

Gifts between spouses and registered civil partners are generally exempt from IHT, so assets can normally pass between them without an immediate IHT charge. However, the spouse exemption may be restricted if the recipient spouse or civil partner is not domiciled in the UK, so the domicile or deemed-domicile position may need to be established before relying on the exemption.

Gifts to qualifying charities are generally exempt from IHT. In addition, where at least 10% of the relevant net estate is left to qualifying charitable organisations, the rate of IHT on the chargeable estate may be reduced from 40% to 36%. The 10% test is subject to detailed statutory calculations, so the amount that needs to be left to charity is not necessarily a straightforward 10% of the gross estate.

ORDER AND TIMING OF GIFTS MATTERS

Where a gift does not qualify for an immediate exemption, it may instead be treated as a potentially exempt transfer (PET) if made to an individual. A PET becomes exempt if the donor survives for seven years from the date of the gift. If the donor dies within seven years, the gift may become chargeable and may use some or all of the donor's available nil-rate band.

Taper relief can reduce the tax payable on certain gifts where death occurs more than three years after the gift, although it does not reduce the value of the gift itself for Inheritance Tax purposes.

The order and timing of gifts therefore matter. Earlier gifts may reduce the value of an estate, but the cumulative effect of gifts, exemptions, PETs and transfers into trust must be considered over the relevant seven-year period. Gifts that are not outright transfers to individuals can also have different IHT treatment, particularly where trusts or retained benefits are involved.

These allowances may seem modest, but when used consistently, they can form part of a wider estate-planning strategy. The practical point is to identify the correct exemption or IHT treatment for each gift and to maintain contemporaneous records showing the date, value, recipient and nature of the gift. Good record-keeping can be particularly important when executors later need to establish the value and timing of lifetime transfers for an IHT return.

REGULAR GIFTS FROM INCOME

One of the most valuable yet often overlooked exemptions is for regular gifts from income. This can apply where gifts form part of normal expenditure, are made from income, and do not reduce your usual standard of living.

This can be useful for people with surplus income from earnings, pensions, dividends, interest, rental income, or other sources. For example, you may wish to make regular payments to children, contribute to a grandchild's savings, or help a family member with ongoing costs.

The key point is that the gifts must be affordable from income after your normal living expenses have been met. If you need to use capital or reduce your standard of living to make the gifts, the exemption may not apply.

Good record-keeping is especially important here. Your executors may need to demonstrate the pattern of gifting, the source of income, and that the gifts did not affect your lifestyle. Without clear evidence, it may be harder to claim the exemption later.

AVOIDING GIFTS WITH STRINGS ATTACHED

Another area where families often go wrong is giving something away while continuing to benefit from it. This is known as a gift with reservation of benefit.

For example, giving your home to your children but continuing to live in it rent-free is unlikely to remove it from your estate for Inheritance Tax purposes. Although the legal ownership may have changed, you have continued to benefit from the asset.

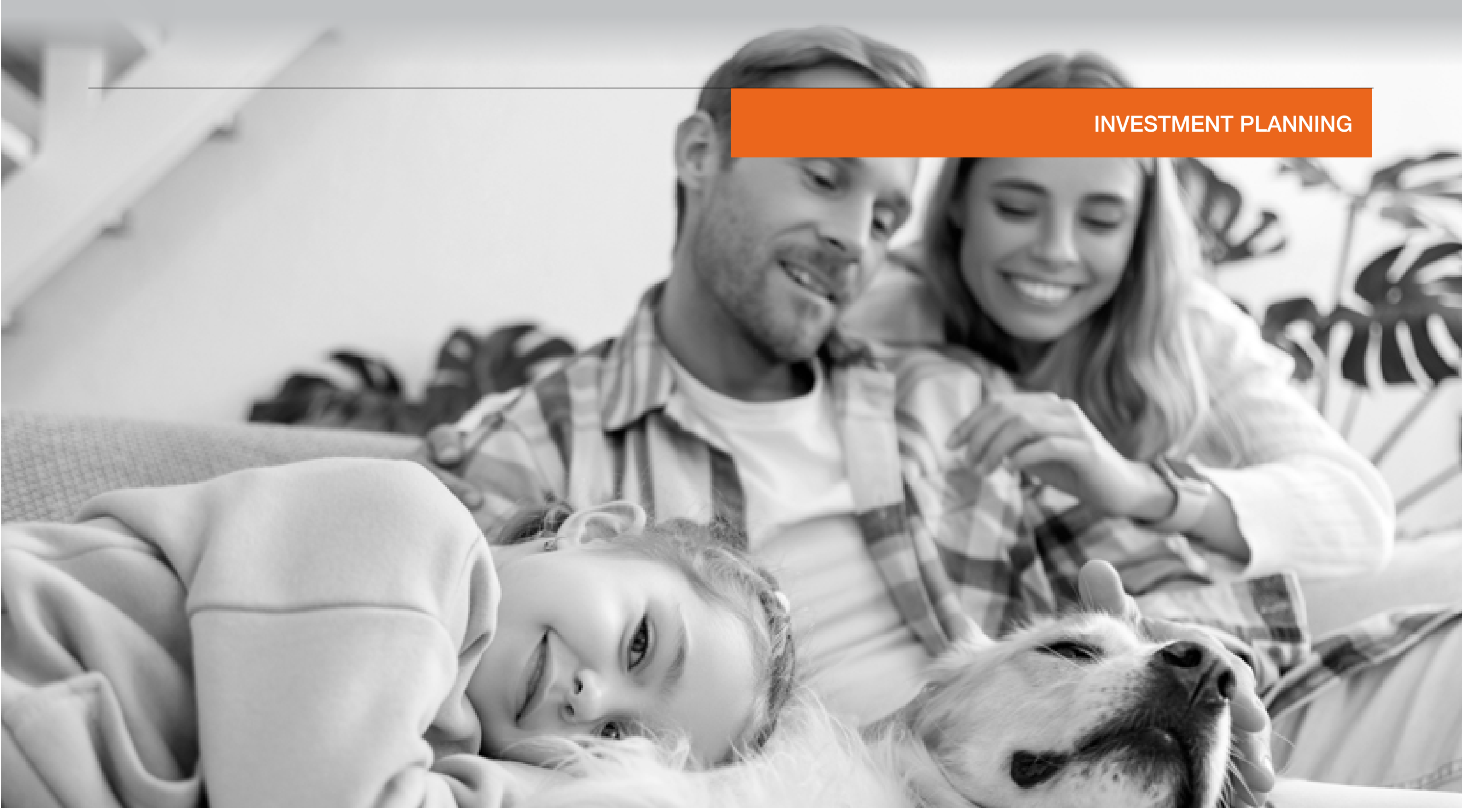
Similar issues can arise with other assets if the person making the gift still has use, control or enjoyment of what has been given away. This can make planning more complicated than families expect.

Gifting should therefore be genuine, affordable and carefully documented. If you wish to retain access or control, other estate planning options may need to be considered.

PROTECTING YOUR OWN FINANCIAL SECURITY

Gifting should never leave you financially exposed. Before giving away assets, it is important to consider how much income and capital you may need for the rest of your life.

This includes everyday living costs, inflation, healthcare, home maintenance, emergencies and potential care needs. You may also want to retain flexibility to support



your lifestyle, move home, help family later or respond to unexpected events.

Once a gift has been made, you may not be able to recover the funds if your circumstances change. This is why estate planning should begin with your long-term financial security, before focusing on tax efficiency.

A financial plan can help you understand what you can afford to give, how gifting may affect your estate, and whether other options may be more suitable.

PENSIONS, GIFTING AND FUTURE PLANNING

Pensions have often played an important role in estate planning, but the rules are changing. From 6 April 2027, most unused pension funds and pension death benefits will be included in the value of an estate for Inheritance Tax purposes.

This change may affect how some families view pensions, retirement income and inheritance planning. It may also make it more important to review beneficiary nominations, pension withdrawal plans and broader gifting strategies.

However, pension decisions should not be driven solely by Inheritance Tax. Your pension may be needed to support your retirement income, protect your lifestyle and provide flexibility in later life.

The right approach will depend on your estate value, income needs, family circumstances and long-term objectives.

KEEPING RECORDS AND TAKING ADVICE

A successful gifting strategy depends on clarity. Families should keep records of gift amounts, dates, recipients, exemptions used, and the source of funds. This can make life much easier for executors and reduce uncertainty when the estate is eventually assessed.

At DG Financial Services, we will help you review how gifting fits into your wider estate planning. This may include assessing your Inheritance Tax exposure, surplus income, pensions, investments, trusts, wills and long-term financial security.

Gifting can be a meaningful way to support loved ones, but it needs careful planning. With the right advice, you can make decisions that are generous, affordable and aligned with your future. ■

Could gifting help your estate planning?

Lifetime gifts can support loved ones and may reduce Inheritance Tax exposure, but the rules are often misunderstood. To find out more, contact DG Financial Services to review your estate planning, understand the gifting exemptions and build a strategy that protects your future.

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