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Wills & Probate for Expats in Spain

How to avoid inheritance tax?

If your estate is sufficiently large, inheritance tax may be payable after you pass away. But there are ways you can cut your estate's tax bill and increase the amount passed on to your heirs.

Keep it in the family.

Transfers between married couples and civil partners are not usually subject to inheritance tax (IHT), so if the first partner to die leaves their entire estate to the other, no tax will be payable.

It's also likely that none of their nil-rate band has been used, and the partner will be able to add the unused balance to their own, effectively doubling the threshold. However, if your partner has left bequests to others (and lifetime gifts made within seven years of death), their estate may attract IHT if it's large enough and may use up some or all of the nil-rate band.

Couples are generally able to inherit tax-free from their married spouse or civil partner. They can also apply any of their partner's unused nil-rate band to their own estate. For example, say your partner left £162,500 from their estate to people other than you. Given the tax-free allowance is £325,000, you can claim only 50% of the tax-free allowance.

On top of the main allowance, the *transferable main residence allowance* means people can leave significantly more, if the estate includes a property being left to direct descendants (children, grandchildren and stepchildren, but not nieces or nephews). In April 2020, this allowance increased to £175,000 from £150,000.

This effectively raises the IHT-free allowance to £500,000 for many people. Where married couples jointly own a family home and want to leave it to their children, the total IHT exemption will be £1m. If this allowance is transferred between spouses, the value of the transferred allowance will depend on when the second, not first, partner dies.

Make gifts

One of the simplest things you can do to avoid paying inheritance tax (IHT) is to spend or give your money away during your lifetime. Each tax year, you're allowed to give up to £3,000 away as a gift, split between however many people you like. You're also allowed to make unlimited gifts of up to £250 to others, too. If you're off to a wedding, you can give up to £1,000 and never have to worry about inheritance tax. You can give up to £2,500 to grandchildren, and £5,000 to your children too. Wedding gifts must be made before the wedding, and the wedding must go ahead, otherwise they'll be classed as potentially exempt transfers. If you make gifts above the thresholds, they may be taxable if you don't survive for seven years after making them.

Leave money to a charity

Any money you leave to a charity, providing it is registered in the UK, will always be free from inheritance tax. The same goes to gifts to political parties, or to local sports clubs. What's more, if you leave more than 10% of your taxable estate to one of these groups in your will, the inheritance tax rate for the rest of your estate will fall from 40% to 36%. The 10% only applies to the amount of your estate over the lifetime allowance. So, for example, if you were leaving behind £425,000, you would benefit from the lower rate if you gave more than £10,000 (10% of the amount over £325,000).

Consider equity release

If all your wealth is tied up in your property, you may not be able to make use of gifts during your lifetime or spend your wealth on yourself. To get around this, some people take out an

equity release scheme. It's important to remember that all this really does is reduce the assets you own and increase the debts that will count against your estate. If you don't need to access cash from your property, giving assets away earlier is likely to be better for you.

With these schemes, you can either borrow money against the value of your home (known as a lifetime mortgage) or sell part of your home at a reduced market rate, but remain living there throughout your life (a home reversion scheme). The money you release can be passed on to your heirs or spent yourself. Providing you survive the gift by seven years, there will be no tax to pay. When you die, the value of your estate will be reduced, either by the mortgage debt (with a lifetime mortgage) or because only part of the value of your home will still belong to your estate (with a home reversion). Think carefully It sounds simple enough, but think carefully before going down this route. With lifetime mortgages, interest is 'rolled up' and your debt can swiftly grow. For example, a £50,000 mortgage with an interest rate of 7% a year will have almost doubled to £98,358 within 10 years. You could end up owing more to your lender than your estate would have paid in tax – either way, your heirs won't benefit. With the other route, you're selling off part of your home for less than its full value. So think about whether you're willing to let the bank take half of your home, just to stop HMRC getting a slice.

Take out a life insurance policy

If you can't beat an IHT bill, you can insure against it, or rather take out a life insurance policy to cover the anticipated IHT bill.

This is one of the simplest ways of covering an unwelcome bill, but unless you're relatively young and healthy, the cost may be high. Providing the policy is written into trust, the payout won't form part of your estate.

HMRC treats the premiums paid to the insurance policy as a lifetime gift if you pay them yourself, but these can usually be covered by one of the tax-free exemptions – either the annual £3,000 exemption or the 'gifts out of normal income' exemption.

Consider a 'deed of variation'?

A deed of variation allows your heirs to alter your will after death so that, for example, part of the inheritance is re-directed to someone else. They can draw up a deed of variation within two years of your death, but all affected beneficiaries under the will must agree to the variation. This can be difficult in practice, especially if there are many beneficiaries.

Review your Will periodically

As a general rule, it's better to review your will periodically so that your affairs are tax-efficient. IHT rates and allowances change with each annual government budget. This will simplify the probate process for your executor and reduce the threat of unnecessary inheritance tax charges.

Take Advantage of Business Owner Exemptions

If you are a business owner, you can transfer interest in your business to a friend, relative or business partner without being subject to inheritance tax. This transfer can be made before or at the time of your death.

It is possible to transfer shares and other finances related to business to a business partner without having to pay any tax. You can then specify that certain assets are transferred to your loved ones at a suitable time after your death.

Transferring Agricultural Land or Buildings

Under the terms of Agricultural Relief, it is possible to transfers certain types of buildings and agricultural land without being subject to inheritance tax.

Buy a funeral plan

The cost of a funeral is rising, and the average cost is between £3,000 – £6,000 nowadays. Therefore, you can deal with this cost upfront through the use of a prepaid funeral plan.

These allow for you to pay for your funeral upfront, meaning that money can't then count towards your inheritance.

Give away assets that are free from Capital Gains Tax

If you own assets, such as shares or property that have fallen value since you bought them, then they can be passed on without attraction any capital gains tax (CGT).