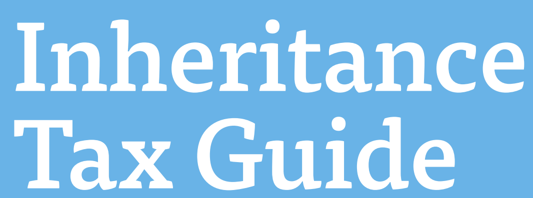

Inheritance Tax Guide

Planning for the future

LIFT-Financial

Chartered Financial Planners

Introduction

Inheritance Tax (IHT) is a tax paid on the estate (property, money, and possessions) of someone who has died.

IHT has been known by several names over the years: Death Duty, Capital Transfer Tax, Estate Duty and was once described by Labour Chancellor Roy Jenkins as "…a voluntary levy paid by those who distrust their heirs more than they dislike the Inland Revenue."

It is also a controversial tax and views on it remain polarised: in many countries around the world including Australia, Canada and Israel, the tax has been removed because of the unfairness of "double taxation".

The description of IHT as a voluntary tax retains some truth: there are ways in which an estate can be organised so that the level of taxation can be reduced and, in some cases, completely eliminated without the need for complex legal structures.

The purpose of this brochure is to set out the options for estate planning in order that you can decide, with the help of your financial planner, whether you want to act.

"There are ways in which an estate can be organised so that the level of taxation can be reduced and, in some cases, completely eliminated without the need for complex legal structures."

Creating a Will

The most important first step in estate planning is to make a will. This is a legal document that ensures your estate is distributed according to your wishes. If you don't have a will, your estate will be distributed based on a set of legal rules (intestacy), which may not reflect your personal wishes.

Understanding Allowances

There are allowances that exempt a portion of your estate from IHT. Currently, the IHT-free allowance is £325,000, which hasn't changed since 2009. There's also an additional allowance related to your residence, currently £175,000 per person but it tapers down for estates worth over £2m. Anything over these allowances is generally taxed at 40%. But there's a reduction to 36% if you leave 10% of your estate to charity.

Whilst not an allowance, the values of most pensions will sit outside an estate for IHT purposes. This is why your financial planner may recommend you spend non-pension assets first.

"The first step in planning is to establish how much capital you will need for your retirement."

Estate Planning Objectives

Effective estate planning is dependent upon understanding potentially conflicting objectives:

- The need to retain capital to support your retirement or to pay for long-term care
- The need to control the investment strategy of your portfolio or the use of the funds
- Balancing the payment of taxes during your lifetime such as Capital Gains Tax with the mitigation of IHT
- To pass an estate intact for business continuation

The first step in planning is to establish how much capital you will need for your retirement. Your adviser can take you through a cashflow exercise to work out an effective strategy based on your circumstances. This could involve spending more, gifting, insuring the liability or Business Relief. However, like most financial planning, this is not a one-off exercise, and you will probably want to keep this under review. Even if you cannot afford to act now, there may still be options for planning as you will see later in this brochure.

Spending

One of the simplest strategies to mitigate inheritance tax is to spend more on yourself or others during your lifetime. By increasing your spending, you effectively reduce the size of your taxable estate whilst allowing you to enjoy your wealth whilst alive.

- Advantage: you get to enjoy more of the funds you have worked hard to accumulate during your lifetime and reduce the amount of inheritance tax your estate will pay.
- Disadvantages: you will leave less of a legacy and, if you accumulate more chattels, these will still form part of your estate.

Insurance

Another straightforward option to address an IHT liability is to take out life insurance. Upon death, the life insurance proceeds can be used to pay off part or all of your IHT bill, or the IHT on a gift you've made.

The cost and availability of insurance will be dependent on age, health, and the amount of cover. Policies can be set up on a whole of life basis or for a set period of time. The latter is usually cheaper, but the risk is that the life insured does not die within the term.

- Advantage: all or part of the IHT liability is guaranteed to be paid on death provided you have paid all the premiums on the policy.
- Disadvantage: you need to ensure that the premiums can be maintained for the rest of your life.

"The life insurance proceeds can be used to pay off part of your IHT bill, or the IHT on a gift you've made."

Gifting

One way to reduce the value of your estate is to give money away and watch it enjoyed during your lifetime by your beneficiaries.

Each year, you can give away up to £3,000 tax-free, as well as small gifts of £250 per person and £5,000 as a wedding gift. Beyond these allowances, other gifts are usually considered Potentially Exempt Transfers (PETs) and only fall outside your estate fully after 7 years. During this period, the IHT liability tapers down.

It is also possible to make gifts out of disposable income, although there are strict rules around this, and records of income and expenditure must be kept so this can be justified.

- Advantages: you can enjoy distributing the funds and watching them being put to good use during your lifetime. You also retain control of the speed and amount of the distributions.
- Disadvantage: a gift cannot be reversed otherwise it will be deemed to be back inside your estate.

"It is also possible to make gifts out of disposable income, although there are strict rules around this, and records of income and expenditure must be kept so this can be justified."

Trusts

If you're not comfortable making large outright gifts, another option is to use a trust. This allows you to retain more control over how your wealth is used.

Gifts into trusts are Chargeable Lifetime Transfers (CLTs) and, provided that the gift is less than the IHT nil rate band, there is no tax charge on the gift. Gifts over the nil rate band can attract a tax charge of half of the standard IHT rate and the value of the trust can be subject to a periodic charge after 10 years.

We would generally recommend you seek legal advice if you're considering using trusts, as the rules and taxation can be complex, particularly around the interaction of PETs and CLTs. We work with a number of solicitors who specialise in this area and can make a referral if required.

- Advantage: trusts are a method of gifting whilst retaining an element of control of the funds including the investment strategy, amount, and timing of distributions.
- Disadvantages: the rules and taxation of trusts are complex and the set-up and administration can be expensive.

Business Relief

Investing in businesses that qualify for Business Relief (BR) can help reduce your IHT. If you hold shares in a qualifying business for two years, their value is generally exempt from IHT. This can be a good option if you can't or don't want to give away assets.

Whilst many more BR qualifying investments have become available in recent years, these types of investments involve higher levels of risk and charges than standard retail investments.

- Advantages: this can be a quick route to getting assets outside an estate and this solution also allows continued access to the funds.
- Disadvantages: these assets can be expensive to acquire and run and are higher risk than standard investments. The underlying investments are specialist and legislation could change so that these types of investment no longer qualify for relief.

"If you hold shares in a qualifying business for two years, their value is generally exempt from IHT."

Disclaimer: This guide is for informational purposes only and should not be taken as personalised financial advice. Always seek professional advice before making any decisions about your estate.

LIFT-Financial

Chartered Financial Planners

lift-financial.com | 0161 929 2626
Century House, Regent Road, Altrincham, Cheshire WA14 1RR

LIFT-Financial – registered in England and Wales – Company Registration Number 06281244 – Our Registered Address: Century House, Regent Road, Altrincham, Cheshire, WA14 1RR. LIFT-Financial Ltd is authorised and regulated by the Financial Conduct Authority. Registration number 471394.

JUN24