Inheritance Tax: Top Tips

Audit / Tax / Advisory / Risk

Smart decisions. Lasting value.

Has there ever been a better time to review your Inheritance tax position?

The recent fall in asset values due to the pandemic does have a silver lining in that it presents a good opportunity for inheritance tax planning. Transfers to trusts can be maximised within tax free limits and any exposure to other taxes on direct gifts is minimised.

In addition, HMRC are currently in the process of radically overhauling the inheritance tax system. If the propose changes materialise this could significantly alter the ability to make certain gifts and transfers of assets tax free (link here to RB article 11 Feb 2020)

With both these points in mind we have outlined below some suggestions to help you make the most of your tax planning opportunities.

Make outright gifts

Making gifts is a very simple way of reducing the value of your estate. So long as you survive the gift by seven years, the gift is not included in your estate on death. If you survive the gift by three years but not the full seven, a reduced amount of Inheritance Tax (IHT) is payable.

Make the best use of the exemptions and reliefs available

Even if a gift is charged to IHT, there are a number of exemptions available which can reduce the amount which is charged to tax. Have you used your £3,000 annual exemption over the last few years? If you have not, both this year's and last year's exemptions are available.

Make regular gifts out of income. With careful planning, the amount that can be gifted can have a real impact on your estate.

If you own part or all of a business, it is worthwhile reviewing it to evaluate if Business Relief (formerly known as Business Property Relief or BPR) would be available against its value. In some circumstances, the value of the business on death can be free of IHT. It is worth noting however that this is one of the reliefs currently under HMRC's review.

Use Trusts

You may want to make gifts to a Trust to benefit the family in the future. There are a number of different types of Trusts and we can help you decide which is most appropriate.

In most cases you can gift up to £325,000 every seven years into a Trust without any immediate IHT charge. The value of the gift plus any future growth in the asset gifted falls outside of your estate once it is gifted. If you gift more than the £325,000, IHT is payable at 20% on the excess. As married couples and those in a civil partnership each have their own nil rate band, together they could transfer £650,000 with no immediate IHT charge.

Trusts specifically for grandchildren are often used to pass assets down the family, skipping a generation. As well as providing IHT benefits, they can be an efficient way of funding school and university fees.

> "Review your investments so that they qualify for Business Relief."

Invest in Inheritance Tax efficient assets

Review your investments so that they are restructured to include assets which qualify for Business Relief. After they are held for two years, the value of the asset held should be free from IHT on death. Some assets you might want to explore are:

- AIM portfolios
- forestry
- property development
- leasing.

Some of these investments can also qualify for the Enterprise Investment Scheme which can provide additional tax benefits such as income tax relief.

Use Investment Trusts known as Discounted Gift Trusts

Discounted Trust plans have two distinct elements, the first providing an 'income' whilst the other is either a chargeable lifetime transfer or a potentially exempt transfer depending on the type of Trust used. This will provide some immediate relief from IHT and total relief on the value of the investment after a period of seven years.

This is a valuable way of making a gift of capital while retaining a fixed income stream for example 5% of the capital gifted per year throughout your lifetime. However, they are inflexible, as future income requirements must usually be determined at the outset.

Insure against the liability

If you do not want to give away your assets while you are still alive or invest in IHT efficient assets, you may want to invest in life cover which can pay out an amount equal to your estimated IHT liability on death.

However, you must make sure you write the policy in Trust, so that the amount paid out is not added to your estate and liable to be charged to IHT itself. You can choose a:

- term policy – which runs for a fixed number of years (you would have to die within the term of the policy for this plan to be effective)
- whole of life policy – which pays out when you die regardless of how far in the future that is.

Policies written on a joint life second death basis, paying out on the death of the last survivor, can be a cost efficient way of dealing with an IHT liability.

Make a tax-efficient Will

A Will sets out what happens to the assets in your estate after you die. It allows you to decide which of your loved ones should inherit your assets and in what proportion. Without a valid Will, your assets will be distributed according to the rules of intestacy, which means your estate might not be divided in the way you would have wished.

Family dynamics can change over time and if you don’t leave an up to date and valid Will in place, the intestacy laws will govern how your estate is distributed, regardless of your wishes. Remember that if you get married, any existing Will you have in place is automatically revoked.

You can also elect to make efficient gifts to charity in your Will. If you leave a bequest to charity of 10% or more of the value of your net estate, your executors may be entitled to pay a reduced death rate of IHT of 36%, rather than the normal 40%.

We will work with your solicitor to ensure your Will is written tax-efficiently so you can maximise certain tax benefits such as the spouse exemption and the main residence nil rate band.

Top up your ISA

Individual Savings Accounts (ISA) are tax-efficient savings. Your surviving spouse can now inherit your ISA, without breaking the tax wrapper advantages.

Although no new funds can be added to this 'continuing ISA', the value of the ISA at the time of your death, plus (from 6 April 2018) any growth arising on it during the estate administration period, will pass to your spouse tax exempt. Upon the death of your spouse, the ISA will form part of their estate for IHT.

IHT-efficient investments

If you own a business, or invest in unquoted trading companies or AIM shares, you may be entitled to IHT business relief (BR), provided you own the shares for at least two years.

Pensions

Pensions are not subject to IHT. If you own a pension which returns a capital value, you may wish to consider drawing down on other assets, which are subject to IHT, in order to generate retirement income. This means that the value of the pension can be preserved and can pass IHT free to your nominated beneficiaries.

Returning to the UK

If you've spent time away from the UK and created offshore structures while you were overseas, you should review these urgently, because there may be tax implications following a change in the rules on how these are taxed from April 2017.

Draft a Lasting Power of Attorney (LPA)

The time may come when you no longer have the mental capacity to make financial or welfare decisions. An LPA allows you to choose someone to make these decisions on your behalf. LPAs are especially important for business owners, because you need to appoint someone who can legally run the business in the event that you are unable to, even for a temporary period.

How we can help

Ensuring your IHT planning is tax efficient is a sensitive subject, and so planning opportunities can be missed. We can review what you already have in place and advise on how and when wealth should be passed on.

Start the conversation

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