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FACTSHEET

Inheritance Tax concerns?

Passing your wealth on to the next generation

A pound saved is a pound earned. But thanks to inflation, over time, the value of the pound saved could be much less than when it was earned. One cannot ignore the corrosive impact of rising prices on investments.

You have worked hard to build your wealth. Passing it on to the next generation fairly, safely, effectively and efficiently takes skill and careful preparation. But some people find the idea of discussing inheritance uncomfortable and subsequently put off estate planning until, in some instances, it may be too late to make a difference.

Seeking early professional financial advice and guidance about the options to mitigate your liability is a sensible move, and there are lots of different options to be considered depending on your individual financial and personal circumstances and preferences.

FUTURE NEEDS AND ASSET REVIEW

By looking at your future needs and reviewing all your assets, including investments, property, businesses, pensions and life assurance, and by gifting and utilising investment reliefs, we can advise you how to plan the most effective way to pass on your wealth. Inheritance tax is an unpopular and controversial tax, coming as it does at a time of loss and mourning.

But as property prices make inheritance tax more of a reality for many in the UK, it can impact on families with even quite modest assets – including those who have been basic rate taxpayers all their lives. It's important to note that Scottish law is different and applies to the estates of people who die domiciled in Scotland, which differs from the rest of the UK.

FAILING TO PUT YOUR FINANCIAL AFFAIRS IN ORDER

It can be difficult to accept that you have to pay tax on your estate – which has usually been accumulated out of taxed income – and that your heirs will not reap the full rewards of your hard work. However, many people who end up paying inheritance tax do so because they have failed to put their financial affairs in order in advance. If you plan proficiently neither you nor your heirs may have to pay inheritance tax at all.

HOW MUCH THE TAX BILL MIGHT BE

The first step in inheritance tax planning is to work out how much the tax bill might be. This isn't easy, bearing in mind the ever-changing values of property and other assets, plus changing legislation. Inheritance tax is levied at a fixed rate of 40% on all assets worth more than the £325,000 nil-rate band threshold per person.

Your tax rate is reduced to 36% if you leave 10% or more of your estate to charity and your estate, including any gifts made by you, can pass inheritance tax-free to a spouse or registered civil partner living in the UK. This can give you a joint allowance of £650,000.

FAMILY HOME ALLOWANCE

From 6 April 2017, a family home allowance was added to the inheritance tax threshold. This is currently £125,000, increasing to £175,000 by 2020/21, and applies where a home is left to descendants of the deceased. Like the nil-rate band, any unused portion is transferable between spouses and registered civil partners.

There are effective and legitimate ways to mitigate against the impact of inheritance tax. But some of the most valuable exemptions must be used seven years before your death to be fully effective, so it makes sense to consider ways to plan for inheritance tax sooner rather than later.

MITIGATING AGAINST INHERITANCE TAX

MAKE A WILL

One of the most important things you can do to help reduce the amount of inheritance tax you could be liable to pay is to write a will. If you die without a will, your estate is divided out according to a pre-set formula and you have no say over who gets what and how much tax is payable. Dying intestate (without a will) means that you may not be making the most of the inheritance tax exemption which exists if you wish your estate to pass to your spouse or registered civil partner.

If you don't make a will then relatives other than your spouse or registered civil partner may be entitled to a share of your estate and this might trigger an inheritance tax liability. You also need to keep your will up-to-date. Getting married, divorced or having children are all key times to review your will. If the changes are minor, you could add what's called a codicil to the original will.

MAKE LIFETIME GIFTS

Gifts made more than seven years before you die, to an individual or to a bare trust, are free of inheritance tax. So it might be wise to pass on some of your wealth while you are still alive. This will reduce the value of your estate when it is assessed for inheritance tax purposes, and there is no limit on the sums you can pass on. You can gift as much as you wish, and this is known as a potentially exempt transfer (PET).

However, if you live for seven years after making such a gift, then it will be exempt from inheritance tax, but should you be unfortunate enough to die within seven years then it will still be counted as part of your estate if it is above the annual gift allowance. You need to be particularly careful if you are giving away your home to your children with conditions attached to it, or if you give it away but continue to benefit from it. This is known as a gift with reservation of benefit.

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CELEBRATING 25 YEARS

FACTSHEET

You can make certain gifts that are given favourable inheritance tax treatment:

- Charitable gifts made to a qualifying charity during your lifetime or in your will
- Potential exempt transfers (PET). If you survive for seven years after making a gift to someone, that gift is generally exempt from inheritance tax
- You can give away up to £3,000 each year, and you can use your unused allowance from the previous year
- You can make small gifts up to £250 to as many people as you like inheritance tax-free
- Weddings and registered civil partnership gifts are exempt up to a certain amount
- You can make regular gifts from surplus income after tax but these need to be documented and lead to no reduction in standard of living for you as donor

LEAVE A PROPORTION TO CHARITY

Anything you leave to charity is free of inheritance tax so it can be a useful way of reducing your inheritance tax bill, while benefiting a good cause. If you leave at least 10% of your estate to a charity or number of charities, then your inheritance tax liability on the taxable portion of the estate is reduced to 36% rather than 40%. This rate is set against the balance of your estate to the extent that it exceeds the available nil-rate band (currently £325,000, although it can be reduced or eliminated by certain gifts made in a person's lifetime).

SET UP A TRUST

Some people who' make gifts to reduce inheritance tax are concerned about losing control of the money. This is where trusts can help. When you set up a trust, it is a legal arrangement and you will need to appoint 'trustees' who are responsible for holding and managing the assets. Trustees have a responsibility to manage the trust on behalf of and in the best interest of the beneficiaries, in accordance with the trust terms. The terms will be set out in a legal document called the 'trust deed'.

You need to bear in mind that there might be capital gains tax consequences if you transfer certain assets into a trust in your lifetime, but there will be no liability to capital gains tax if you establish a trust in your will. The rules changed in 2006, making some of them less tax effective as a small minority of trusts are subject to their own tax regimes and will require you to pay inheritance tax even before you have died, but they're still worth considering. Also, trustees are likely to be liable for income tax at a rate of 45% and capital gains tax at 28%.

INSURANCE POLICY

If you don't want to give away your assets while you're still alive, another option is to take out life cover, which can pay out an amount equal to your estimated inheritance tax liability on death. It's essential that the policy is written in an appropriate trust, so that it pays out outside your estate.

One option could be to purchase a whole-of-life assurance policy designed to provide funds to the beneficiaries of your estate in the event of your death to meet the cost of any inheritance tax bill payable.

TIME TO CARRY OUT A FULL REVIEW OF YOUR ESTATE'S POTENTIAL LIABILITY?

Inheritance tax is not completely out of your hands. Whether you are taking a principled stand or a practical one, you do have some control. We can carry out a full review of your estate's potential liability to inheritance tax and advise you if there is any scope to reduce your estate's exposure to inheritance tax. To find out more please contact us – we look forward to hearing from you.

BUSINESS PROPERTY RELIEF

Business property relief can be a very effective way to remove assets from your estate but still have full access to the funds if needed in the future. You can hold shares in the portfolios of certain companies; they are considered business assets and attract 100% relief from inheritance tax. You'll only need to hold these shares for two years to qualify for business property relief. Qualifying companies include most of those trading on the London Stock Exchange's Alternative Investment Market.