Whitechurch
Financial Consultants
A Division of Whitechurch Securities Ltd

Inheritance Tax

- A Useful Guide

Tax Year ending 5th April 2024

Head Office: The Old Chapel, 14 Fairview Drive, Redland, Bristol, BS6 6PH.

Telephone: 0117 452 1208

Website: www.whitechurch.co.uk

Qualified Member
Personal Finance Society

Contents

Introduction

Inheritance tax (IHT) is, essentially, a tax levied on any transfer of assets to other people or trusts. It is mostly paid in respect of an individual's estate on death, but it can also apply in respect of certain transfers of assets during life.

When IHT is levied on the value of an individual's estate after their death it is payable by the executor of a Will (where a Will exists) or by an Administrator in the case of dying intestate (no Will) before assets can be distributed to beneficiaries.

Included in the estate will be certain gifts made within seven years of death or, made at any time, when there is a reservation of benefit which continues within seven years of death.

Each individual who is UK domiciled is allowed an IHT nil rate band which is effectively a value of your estate taxed for IHT purposes at zero per cent. This amount is currently £325,000 and has been frozen until 2026.

Legislation in October 2008 decreed that married couples can inherit any unused part of the first dying partner's nil rate band. Effectively giving married couples a joint nil rate band, currently valued at £650,000. However, this will only be possible if your Wills have been written in such a way that no part of the nil rate band is used upon the first partner's death.

The 2015 Budget introduced a new 'family home allowance' (now referred to as 'residence nil rate band') worth £175,000 per person in 2022/23. This has also been frozen until 2026

This now allows individuals to pass on assets worth up to £500,000, including a family home, without paying any IHT at all. For married couples and civil partners, the total is therefore £1 million. This additional allowance is gradually withdrawn, however, for estates worth more than £2 million.

How to manage IHT

Growing Problem

With property values climbing over recent years and markets recovering from the lows of the recession, many people will now find their estates subject to IHT.

(HMRC National Statistics)

IHT is payable on death if you make a transfer of chargeable property which, after deduction of liabilities, exemptions and tax reliefs, exceeds the nil rate band. You can try the following calculation to give you an indication of whether your estate will face IHT:

Value of all assets – Liabilities	= Estate Value
Estate Value – Available nil rate band (i.e. £325,000 or £650,000) & residence nil rate band (i.e. £175,000 or £350,000)	= Taxable Estate
Taxable Estate x 40% Death Tax	= IHT due

Inheritance Tax Calculation

Here's an example of what could occur in the 2023/24 tax year:

» Fred and Marjorie were married with three adult children. Their estate is valued at £1,010,000, including a property of £650,000 and various investments of £360,000. They had mirror Wills that leave everything to each other and then their children equally, but they had not taken steps to reduce their potential IHT liability.

» Unfortunately Marjorie passed away in December 2016 and her estate passed to Fred. There was no IHT to pay at this point because transfers on death between spouses are exempt from IHT.

However, on Fred's death the following IHT will be payable:

£1,010,000 - £650,000 (joint nil rate band) = £360,000

£360,000 - £350,000 (joint residence nil rate band) = £10,000

£10,000 x 40% death tax = £4,000 IHT

This tax bill would need to be paid before the remainder of the estate, £1,006,000, is distributed to the children. Marjorie and Fred worked hard and duly paid taxes all their lives. Now, on their death, Her Majesty's Revenue and Customs will receive a further £4,000 from their estate. This guide provides introductory information on how the potential impact of IHT can be managed.

Will IHT apply to me?

Under current legislation, IHT is often perceived as a voluntary tax. This is because with careful planning, it is possible to reduce or remove any liability altogether.

Exemptions

Exempt transfers are those which can be made without a tax liability. The most important include:

- Spouse exemption – transfers between UK domicile spouses and registered civil partners whether during life or on death.
- Annual exemption – lifetime transfers of up to £3,000 each tax year are exempt.
- Small gift exemption – outright gifts of up to £250 in any one tax year to any number of people are exempt.
- Normal expenditure out of income – lifetime gifts which are of a regular nature, and made from net income, qualifies for an exemption if they do not affect your normal standard of living.
- Marriage gift exemption – gifts made by certain people in consideration of a marriage or civil partnership taking place are exempt:
    - from a parent £5,000
    - from a grandparent £2,500
    - from others £1,000
- Charities – Gifts and bequests to a UK registered charity or other qualifying body.
- National Benefit – Gifts and bequests to certain national institutions such as the National Gallery or British Museum.
- Political Parties – A transfer of value to a qualifying political party.

Tax Relief

Certain assets get relief from IHT. The most important include:

Business property relief – 100% relief is available in respect of a sole trader's business, the interest in a business of a partner, or a shareholding in an unlisted company. Land, buildings, machinery or plants owned personally by an individual, or a controlling shareholder, qualifies for 50% relief. You can only get relief if the deceased owned the business or asset for at least two years before they died.

Agricultural property relief – 100% relief is available in respect of the agricultural value of land and farm buildings.

Chargeable Transfers

These are transfers which are neither exempt, nor potentially exempt. The most common chargeable transfers are lifetime gifts into discretionary trusts. A transfer will be chargeable if it (together with transfers made in the previous seven years) exceeds the IHT nil rate band.

Use of Trusts

There are a number of trusts which can be used, the suitability depending on the precise requirements of the individual and the tax consequences of the trust. Some of the reasons for establishing a lifetime trust include:

- The ability to make a gift of assets while maintaining control
- Providing for minor children who are too young to take legal responsibility for gifted assets
- Avoiding or reducing IHT, capital gains tax and income tax
- Providing a flexible environment for the future

Types of Trust

- **Bare Trust** – a bare trust is one which once the beneficiary has been named they cannot be changed and they are absolutely entitled to benefits, both income and capital at the age of 18.

- **Discretionary Trust** – this is a trust where lists of named beneficiaries, or categories of beneficiaries, are entitled to the trust fund. The trustees have the discretion to appoint capital and income to any beneficiary or beneficiaries.

Potentially Exempt Transfer (PET)

This is a term which describes gifts of cash and assets which, subject to certain conditions, will not incur a liability to IHT. Gifts between individuals or into bare trust arrangements are termed PETs. A PET made more than seven years before death becomes an exempt transfer. If death occurs within seven years, then the gift becomes taxable, subject to any taper relief and the nil rate band.

Life Assurance

Whole of Life Assurance is the oldest established and, arguably, the most effective method of meeting an IHT liability. As the date of death is uncertain, a Whole of Life policy is affected to make sure that capital is available at death to meet the IHT bill. Policies are normally written under a suitable trust arrangement to make sure the policy proceeds do not compromise the deceased's estate upon death.

Pension

With the changes to pension rules that came into effect from 6th April 2015, a pension can also be used to pass on benefits without tax.

Common misconceptions about Inheritance Tax

"I will gift my money away nearer the time"

It is possible to gift up to £3,000 per year and not have to pay Inheritance Tax on it. You can also gift £5,000 to a child when they get married and you can gift sums of £250 to as many people as you like. There are also some other scenarios in which you can gift money free of IHT - such as to charities, political parties and museums. However, you can't simply give away all your wealth shortly before you die and escape IHT. You have to survive at least seven years after making a gift for its value to fall out of your estate. Until then it is known as a Potentially Exempt Transfer and may fall back into your estate and be liable for IHT if your estate's value exceeds the nil-rate threshold of £325,000 when you die.

"I can now pass on £1m free of tax"

The new limit introduced by the last government came into effect from April 2017. However, the additional nil-rate allowance applied only if you gifted your home when you die.

2018-19	£125,000
2019-20	£150,000
2020-26	£175,000

So although in 2022-2023 the personal allowance is £325,000 + £175,000 = £500,000, that's still not £1,000,000 each! Only couples who are married or in civil partnerships are able to combine their personal allowances of £500,000 each to reach the magic number of a £1,000,000 nil-rate allowance.

Furthermore, the residence nil rate band is reduced by £1 for every £2 that the deceased's estate exceeds £2m. This means that no RNRB is available for someone whose estate exceeds £2.35m in 2023/24.

"I don't need a Will as my assets will automatically go to my partner when I die"

Many couples think that they don't need to worry about IHT as their partners will inherit everything free of tax. However, without a valid Will in place, under the rules of intestacy, a portion of an estate will go to existing children and this could trigger an Inheritance Tax liability – one that could have been avoided with a Will in place.

"It's too late; it takes 7 years for any gift to leave your estate"

This notion prevents elderly people from considering Inheritance Tax planning. Whilst the seven year period is true, the statement itself does not tell the whole picture.

Gifting into a trust can mitigate tax liability and there are financial planning products that can assure you for the risk of dying prior to the 7 years it takes for a gift to be excluded from your estate.

It is also possible to reduce IHT liability if an asset is gifted three years or more before death. In certain circumstances, gifts made 3 to 7 years before death are taxed on a sliding scale, which is known as 'taper relief'.

Years between gift and death:	Rate of relief
0-3	0%
3-4	20%
4-5	40%
5-6	60%
6-7	80%
More than 7 years	100%

"I don't want to lose control of my money in case I need it"

This is often a major dilemma for people. They either want to try to spend their IHT liability or keep it set aside for future costs.

The issue of losing control of funds can be true, however, there is a type of trust called an Interest in Possession trust where the settlor can be the 'income beneficiary' and is able to receive income payments which could be used for care home costs or perhaps even a holiday or new car – depending on the terms of the trust. At the settlor's death the capital would then go to the 'capital beneficiary.'

Interest In Possession Settlor places capital sum in this trust.

→ Settlor is the 'income beneficiary' and receives income from the capital.

→ Under normal 7 year rule, the capital sum, reduces IHT liability and goes to the 'capital beneficiary.'

"I am too young to begin planning for my children's inheritance, I've only just retired!"

You have only just entered the life stage of retirement, you're planning how to take benefits from the money you have saved your whole working life. The last thing you want to think about right now is giving it away!

However, there are advantages of planning Inheritance Tax mitigation earlier on. For a start, you are more likely to live longer so you can fully benefit from the 7 Year Rule for gifts.

Lifetime gifting is an established means of mitigating IHT. Other than Exempt Transfers or Potentially Exempt Transfers, you can also make use of a Chargeable Lifetime Transfer. However, with this type of gift it is possible to be caught out by the lesser-known 14 Year Rule! Hence, it is another reason to start your IHT planning mitigation sooner rather than later.

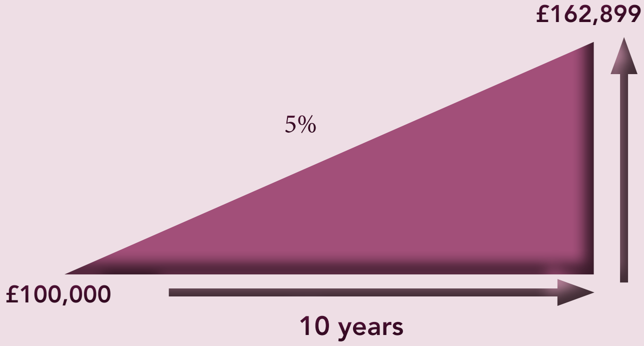
It is also possible to cover your IHT liability with a life assurance policy that pays out to your beneficiaries on your death. The premiums are more manageable when the policy is started earlier in life.

"ISAs are the most tax efficient form of investing!"

The more accurate statement would be: "ISAs are one of the most tax efficient forms of investing!" An ISA may not be the best option if there is a sizeable amount of other assets. This is because of the impact that Inheritance Tax would have on a deceased person's ISA. The impact of IHT could reduce the value of the estate to less than the outcome of an alternative investment strategy. Take a look at the two following scenarios.

Scenario 1:

A transferred ISA with a value of £100,000, plus growth achieved over 10 years - based on a 5% pa growth rate.



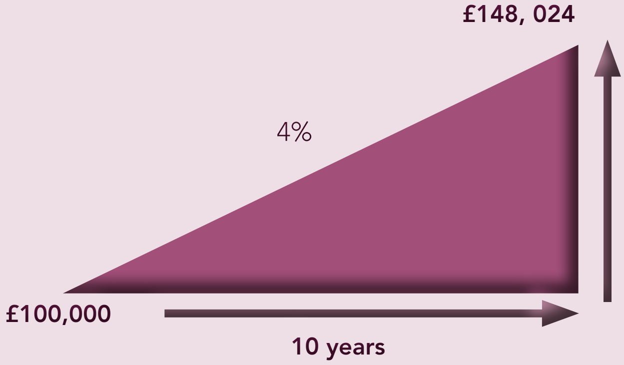
In this scenario, over 10 years the ISA builds up to £162,899. However, ISAs are not exempt from Inheritance Tax. As such, after this person dies their nil rate allowance will be used up by other assets and the value of the ISA will be reduced by IHT.

£162,899 x 40% IHT = £65,160 Inheritance Tax liability

This means that after 10 years of growth, the value of the ISA is now £97,739.

Scenario 2:

An inheritance tax-efficient investment – written into trust. Starting value of £100,000 plus growth achieved over 10 years – based on 4% pa growth (5% less 20% internal tax):



In this scenario, over 10 years the investment builds up to £148,024. However, because it is in an IHT tax efficient investment, when this person dies there is no IHT to pay so the investment remains at £148,024 for the beneficiary.

This is a potential saving of £50,285 due to using an IHT efficient solution instead of an ISA.

Comprehensive Wealth Management

At Whitechurch we know that estate planning and inheritance tax mitigation is a complicated area, and getting it wrong or doing nothing can be very costly. Therefore, if you would like to talk to a financial adviser, please get in touch with us. We are passionate about helping people who are serious about enhancing their wealth, improving their standard of living and creating a secure long term financial future for themselves and their families.

Our team of experienced, highly qualified advisers deliver a comprehensive wealth management service, built on individually tailored financial planning advice. We also work closely with the award winning Whitechurch Investment Management team to create investment portfolios for clients.

You may wish to make your loved ones aware of what you have in place so that they can carry out your wishes. If you are planning to leave inheritance to others, it can be just as complicated to know what to do with the money when you receive it. Let them know that Whitechurch could offer them free or discounted advice so that you know your legacy is looked after properly.

Whitechurch Financial Consultants:

Telephone: 0117 452 1208

Email: wfc@whitechurch.co.uk

Website: www.whitechurch.co.uk

Head Office: The Old Chapel, 14 Fairview Drive, Redland, Bristol, BS6 6PH. **Telephone:** 0117 452 1208

Website: www.whitechurch.co.uk

FP3192.14.05.21

MIX
Paper from responsible sources
FSC® C002239
FSC
www.fsc.org