Your guide to inheritance tax

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Your guide to Inheritance Tax

The combined effect of rising property values, positive investment returns and a 10-year freeze on the tax-free threshold, means more people than ever are paying Inheritance Tax (IHT).

In 2020/21, £5.4 billion of Inheritance Tax was paid, over double the amount in 2009/10

In 2018/19, 22,100 estates paid Inheritance Tax, almost double the number in 2009/10

The headline rate of Inheritance Tax is 40% of your taxable estate.
This guide will help you understand more about IHT, whether you are affected and what you can do about it.

The basics

IHT is potentially paid on the value of your estate when you die. Your estate includes assets, such as:

- Property
- Savings
- Investments
- Possessions
- Business interests

IHT is only paid on the proportion of your estate that exceeds two key thresholds:

Nil Rate Band: This is currently £325,000 and hasn't changed for more than 10 years. If your entire estate is valued below this threshold, no IHT will be due when you die. However, should the value of your estate exceed this threshold, tax may be due.

Residence Nil Rate Band: This is a complex addition to the IHT rules. In simple terms, it increases the amount homeowners can pass on to their direct descendants without IHT. In the 22/23 tax year, the Residence Nil Rate Band adds £175,000 to the £325,000 Nil Rate Band.

No IHT is paid on the value of any assets passed to your spouse or civil partner when you die. They can also inherit any unused Nil Rate Bands.

Case study

Changes to legislation and the introduction of the Residence Nil Rate Band mean IHT has become increasingly complex. The following case study shows how it works in practice and the cost to your beneficiaries if you don't plan ahead

George and Emma are married and have a 30-year-old daughter, Chloe.

Their assets are all jointly owned and include a £600,000 house, investments of £1.1 million and other assets worth £100,000.

- George dies in June 2019, passing all assets to Emma
- As she is his spouse no IHT is payable
- George's Nil Rate Band and Residence Nil Rate Band are unused and pass to Emma
- Emma dies in May 2021, leaving her entire estate to Chloe

The executors of the estate utilise Emma's Nil Rate Band of £325,000 plus an equal amount inherited from George. Furthermore, because their home is being left to Chloe an additional £350,000 of Residence Nil Rate Bands are available.

Therefore, Chloe inherits £1,000,000 without paying tax.

However, **IHT of £320,000** is payable on the remainder, reducing the amount Chloe inherits from £1,800,000 to £1,480,000.

If George and Emma had taken advice during their lifetime the IHT bill could have been reduced leaving Chloe with a larger inheritance.

"Effective IHT planning could save your family hundreds of thousands of pounds. If you haven't done anything about a potential IHT bill, the sooner you start to consider this area, the better. There are a range of options for those seeking to reduce their IHT liability upon death, including making a Will, the use of trusts, life assurance and making use of the various exemptions. These options should all be considered in conjuction with either regular or one off gifting strategies."

Steve Pyne
Managing Partner, Holden and Partners

Nine ways to reduce your IHT liability

There are many ways to **reduce your IHT liability** In some cases, it's possible to entirely eliminate them.

Naturally, estate planning and IHT mitigation should be based on your individual circumstances and ambitions and, before taking any action, you should consult an appropriate professional adviser. However, options can include:

1.Writing a will

Estate planning starts by ensuring you have a will in place which accurately reflects your wishes. Without a will, your assets will be distributed according to intestacy rules, which might not reflect your wishes and may result in IHT being paid unnecessarily.

2.Using exempted gifts

You can make gifts each year up to a certain level, which are immediately excluded from your estate for IHT purposes. Exempted gifts include up to £3,000 per year, known as the 'annual exemption' and gifts up to certain values in respect of marriage.

3.Making larger gifts

There is no limit on the amount of capital you can give away. However, unlike exempted gifts, these remain potentially liable for IHT for seven years. Choosing to make gifts during your lifetime can help reduce the value of your estate. You will also be able to see the impact of your generosity during your lifetime. However, care must be taken to ensure that by making such gifts your lifestyle won't be adversely affected.

4.Gifts from surplus income

You may prefer to make gifts from income rather than capital. If these are regular and don't reduce your standard of living, the gifts should immediately reduce your IHT liability.

5.Trusts

Trusts can be an effective way of reducing IHT liabilities. Provided certain conditions are met, assets placed in trust no longer belong to you. Therefore, they're not considered part of your estate when IHT is calculated, providing you have lived for at least seven years after making the gift. There are many different types of trusts, which can be complex, so it's important to consider which options may suit your objectives.

6.Business Relief

Shares in certain types of companies are exempt from IHT. These could be companies which you control or those in which you have invested. Providing the shares meet the qualifying criteria and you own them for at least two years, this can be a very effective way of reducing potential IHT liabilities.

7.Pensions

Money held in pensions is usually exempt from IHT and it is, therefore, worth considering maximising the level of contributions you make each year. In addition, at retirement, it might be sensible to consider drawing an income from other sources which are potentially liable to IHT, rather than your pension.

8.Life Insurance

While not reducing the amount of tax payable, taking out life insurance can be a simple way of dealing an IHT liability. The life insurance is used to pay the tax liability leaving the remaining value of your estate for your beneficiaries, with the added benefit of the sum assured paid before probate.

9.Charitable donations

By leaving more than 10% of your net estate to charity, the IHT rate reduces from 40% to 36%. It gives you an opportunity to minimise your IHT liability while supporting good causes that are close to your heart.

Planning to pass on your wealth

With prudent planning, it is usually possible to use one or more of these strategies to reduce the IHT your estate is likely to pay and potentially give to your loved ones while you can see them enjoy the benefit of your gift. However, balancing your present needs with taking action to mitigate a future liability is a complicated task and this is where professional help can be extremely beneficial.

Working with a financial planner to put together an integrated estate plan can help you to:

Manage your savings and investments, and quantify the amount you need to provide a consistent retirement income	Ensure more of your wealth passes to the individuals or causes you want it to by minimising IHT
Provide for your children and other family members by helping them with costs for education, property purchases and so on	Feel confident that those inheriting from you will get the most out of their windfall by using it responsibly and in line with your wishes

Where your family or other loved ones will be the recipients of your wealth, they should be involved in the process of developing your plan as much as possible. With more than £5 trillion expected to pass between generations in the next 30 years , it is much more common for families to openly discuss what younger generations can expect to receive and we encourage this for several reasons:

- Recipients of inherited wealth know what to expect and are well prepared, and can even incorporate your gift into their own financial plan, for example it may be used for their own children's school fees.
- There is peace of mind that the money will be well used, perhaps with a trust to ensure the money is used for certain pre-defined purposes or not before a specified age.
- A family financial planner can also help to educate younger family members so that they understand what they have inherited. Grandparents, for instance, might have saved in a junior ISA, children's pension or trust, which a young family member may not be familiar with.
- The administrative burden is eased, as inheritors are aware of your financial affairs and various savings and pension plans.

Although it may seem daunting, building an estate plan with your financial adviser allows you to start passing money on to family or causes you are close to so that you can see them use it. If you have concerns about how money might be used, doing so in your lifetime also allows you to keep some control over it.

Getting started sooner means you can start to make use of the gifting exemptions and reduce the IHT your estate might otherwise pay.

1. Barclays; https://www.barclays.co.uk/smart-investor/news-and-research/market-analysis/are-you-ready-for-the-great-wealth-transfer/

When should you seek advice?

The number of estates paying IHT is rising and so is the amount being paid. However, there are many ways to reduce the tax due when you die, while maximising the amount you leave to your loved ones and good causes.

The first step is to understand whether your estate will be caught by IHT. If you can answer 'yes' to any of the following questions, it's likely you will benefit from advice.

Yes	No	
☐	☐	Are you unsure of your estate's value?
☐	☐	If you don't own a property: Are your assets worth more than £325,000?
☐	☐	If you own a property: Are the value of your assets (after deducting outstanding mortgages) worth more than £500,000?
☐	☐	Are you likely to receive an inheritance in the future?
☐	☐	Would you like to make gifts while you are alive but are unsure how your lifestyle might be affected?

Contact Us

Over the years, we've helped many people reduce the Inheritance Tax paid when they die. We are experienced, highly qualified, and STEP (The Society of Trust and Estate Practitioners) affiliated advisers, demonstrating our estate planning specialism.

If maximising the amount you leave to loved ones and good causes is important, please contact us. We'll listen to your concerns, understand your ambitions, explain your options and make recommendations.

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