Inheritance Tax Planning
Key Information

Inheritance Tax planning

Under current legislation, an estate will be subject to Inheritance Tax (IHT) at 40% if, on death, it exceeds the nil rate band (presently £325,000).

An extra £175,000 IHT allowance on the family home will be phased in from April 2017. This will combine with the original allowance to give some individuals a £500,000 allowance when leaving property to children and direct descendants on death and a combined £1m for spouses and civil partners.

However, there are a number of schemes and solutions available to help mitigate IHT or produce funds to enable your executors to settle this tax bill.

They broadly fall into one of three stages of financial planning:

- Arranging your estate tax efficiently.
- Giving during your lifetime.
- Covering any liability with life assurance.

Arranging your estate tax efficiently

This stage of financial planning will help ensure that your assets are transferred efficiently on death and may include some, or all, of the following methods of planning:

Making a Will or ensuring that your existing Will reflects your current circumstances and legislation

If you die without having made a valid Will, your assets will be distributed in accordance with the laws of intestacy. Those rules are unlikely to reflect your intentions. They may also mean that your nil rate band is wasted or that your estate is taxed in a way which could have otherwise easily been avoided. Finally, there may also be a delay before your assets can be distributed to your family.

If you own a business, it is important to ensure that your Will also covers your business assets or, alternatively, that you have put in place appropriate succession planning with your business partners.

Ensuring any life plans you own are written in an appropriate trust

You may have taken out a plan to provide a lump sum for your beneficiaries following your death. If you haven't protected that plan through the use of a trust, the proceeds may be subject to IHT following your death, meaning that your beneficiaries could receive as little as 60% of what you had intended. Without a trust, there will also be a delay before the lump sum could be paid.

Making provision for any lump sum death benefits from pension schemes

Although the payment of death benefits from pension schemes is generally free of tax, it is important to consider the longer term protection of such funds. If you have requested that the benefits are paid to an individual such as your spouse or child, the payment may be subject to IHT on their subsequent death. Even worse, up to 100% of what you leave could disappear in the event of divorce or bankruptcy. It may also prevent the individual from qualifying for local authority funded long term care or other means tested benefits.

Lump sum pension death benefits can be protected for the longer term benefit of your family in all of these circumstances through the use of a special trust.

Giving during your lifetime

Rather than leaving your entire estate to your heirs via your Will, an alternative is to make gifts during your lifetime to bring forward this passing of wealth. Transferring your accumulated wealth in this way reduces the size of your estate, and ultimately, any IHT liability. Some gifts are immediately exempt from IHT and some take seven years to be fully effective. A well planned giving strategy should ensure that any giving exemptions are used as this will provide maximum tax efficiency.

Giving to a trust, rather than to an individual or individuals, may help to provide longer term asset protection as well as allowing you to retain control (but not personal use) of assets.

If your circumstances prevent you from making an outright gift, there are trusts which will provide you with some form of retained benefit – perhaps a regular income, funds if you need long term care in the future or access to a capital lump sum.

Covering any liability with life assurance

Probably, the most frequently used form of IHT planning is the creation of a fund to cover the liability through the use of life cover. Employing this method of planning may allow you to avoid making significant gifts during your lifetime to reduce the size of your estate but you will need to pay for the life cover. Alternatively, it is possible for your heirs themselves to meet this cost – after all, it is ultimately their inheritance that will potentially be reduced by the effects of the tax bill.

If you are paying for the plan yourself, you will need to ensure that it is protected from IHT by a trust. When setting up a trust, it is important to ensure that you appoint one or more additional trustees. If you die without having done so, there will be a delay whilst probate is granted, before the lump sum can be paid to your heirs.

Your own planning

Although the three stages of IHT planning are relatively straightforward, no one method is likely to provide a complete solution. Any planning strategy that you implement will need to reflect your own individual circumstances and requirements and may include some, or all, of the solutions from the three stages mentioned.

It is combining these solutions that can make IHT planning a complex matter, particularly as many estates and situations will be complex, involving overseas assets, business assets, family situations involving a previous divorce, second marriages or existing trusts, among other things. It is an area where professional advice should be sought.

If you would like further details about any of the planning methods referred to or wish to implement a planning strategy yourself, please contact your financial adviser, they will be able to advise on the most complex of situations.

Important

Wills and trusts are not regulated by the Financial Conduct Authority or the Prudential Regulation Authority.

The levels and bases of taxation and reliefs from taxation can change at any time and are dependent on individual circumstances.

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