Keeping you informed

A GUIDE TO INHERITANCE TAX

Safehands Independent Financial Advisers Limited

enquiries@safehandsifa.co.uk
01242 516784

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Two certainties in life

How much will you pay?

Reducing your inheritance tax bill

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Life insurance

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TWO CERTAINTIES IN LIFE

Death and taxes are often described as the only two certainties in life, as gloomy as it may sound...

Making plans around Inheritance tax (IHT) involves discussions around these two certainties at the same time.

Although this can often be a complicated scenario, there are plenty of ways to reduce or remove IHT altogether. It is important to remember that the sooner you plan for this scenario, the more likely you are to be in a better position later in life.

This guide is designed to provide useful information on IHT and demonstrate some of the steps you can take to help reduce or remove the IHT, meaning you can pass on more to your loved ones.

Speak to your Financial Adviser today to help explain the concepts illustrated in this document and begin to plan for your future.

HOW MUCH WILL YOU PAY?

First, you need to work out if you will need to pay IHT by calculating the value of the assets that you own. The key below gives an idea on the items you will need to consider as part of this.

ASSETS

Life insurance (where not held in trust).

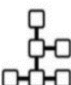
Cash.

Investments.

Trust Investments of which you are a life tenant, established following the death of another person.

Other Properties

Your Home



Possessions

There are some assets you won't need to include in the calculation, for example certain investments in small companies (unlisted companies or those listed on the alternative investment market). You can also deduct any debts including mortgages from the value.

Once you have worked out the value of your estate (assets less liabilities), you can subtract the current IHT thresholds.

The current IHT threshold stands at £325,000 per person and has been frozen until 2027. You normally won't pay inheritance tax on anything under £325,000*, known as the nil rate band.

Under normal circumstances, you will pay IHT at a rate of 40% on the value or your estate over this amount.

There is also an additional allowance the Residence Nil Rate Band' (RNRB) that maybe available, if you pass on your family home to a direct descendant which is currently set at £175,000. For any joint assets, just include your share.

The RNRB will gradually reduce, or taper away, for an estate worth more than £2 million, even if a home is left to direct descendants. This will reduce by £1 for every £2 that the estate is worth more than the £2 million taper threshold.

If you are married, you can combine your thresholds if your spouse will inherit all your assets on your death. Similarly, if you've been widowed in the past, you may be able to claim the IHT thresholds which were unused by your late spouse.

*It may be reduced if you have made gifts within the seven years before your death.

BEST PRACTICE

FOUNDATIONS

Before you start to reduce any potential IHT bill, you should ensure you have the right foundations in place.

PRIORITISE YOUR OWN SECURITY

You should think of your own needs first and make sure you strike a balance between making sure you have enough money to live on and paying less tax.
Things to consider would include:

- What you'll need throughout your lifetime
- What your partner will need if you die before them
- Inflation – rising prices can eat away at the value of your savings
- The possibility and costs of long-term care

MAKING A WILL

A will is the foundation of any IHT planning and is legally binding. Writing a will means choosing who will benefit when the time comes, as well as how and when.

If you don't write a valid will, your estate will be subject to the laws of intestacy, which will determine who benefits and this may differ from your wishes.

SELECTING AN ATTORNEY

Making and registering a Lasting Power of Attorney (LPA) to carry out your wishes during your lifetime can help if you become unable to manage your own affairs later in life. This needs to be in place before you lose the capacity to make your own decisions.

There are two types of LPA. One covers financial matters including property, and the other covers health and welfare decisions. Completing an LPA doesn't mean someone will immediately control your life, they must act with your best interests in mind. An LPA can only come into effect when you specify or when capacity is lost.

The benefit is you can choose who can act for you if the time comes. If you don't appoint an Attorney, your relatives will have to apply to the Court of Protection if you lose the ability to make your own decisions. This can be a slow and expensive process. You wouldn't be able to select your own Attorney in this instance or specify how you'd like your affairs to be managed. The Court would appoint an Attorney for you, and this might not be someone you would have chosen otherwise.

The Financial Conduct Authority does not regulate Will writing or Legal Powers of Attorneys.

REDUCING YOUR IHT BILL

There are various ways in which you can reduce your IHT bill, with varying degrees of complexity and risk.

SPENDING

Spending your money will reduce the value of your estate and the amount of IHT you need to pay. If you are considering IHT planning, it may be an opportunity to spend some of your hard-earned money on things you enjoy, like holidays, eating out etc. However, if you buy expensive items, e.g., cars, watches, art etc. these will be assets that remain in your estate.

It is unlikely spending will make much impact on your IHT bill unless you make a significant change to your lifestyle, and this brings with it, risks around having enough money to live on for the rest of your life.

GIFTING

Giving away money provides an opportunity to pass money onto loved ones, giving them a helping hand for their future, whilst at the same time reducing the size of your estate. There are, however, rules around making gifts and how they are treated for IHT purposes.

You should also take care when making gifts. You will lose control over any gift you make as you can't take this back or dictate what the recipient will do with it. You are also no longer able to benefit from any income or capital gain from the gift's value.

INVESTING

Some investments offer IHT savings, however these come with higher investment risk and therefore come with the potential for capital loss.

It is important to remember that these are not suitable for the majority of investors and you could lose the value of your investment.

We will go into some details as to the types of investments available to you, but for more information it's important to seek the advice of a financial adviser.

SOUND CONFUSING?

Your financial adviser is there to help support you and your loved ones and to ensure that you fully understand the concepts discussed in this guide.

TYPES OF GIFTS

In this section, we will go through the types of gifts, in what context they are applicable and the tax implications they may incur.

EXEMPT GIFTS

These are free of IHT immediately.

POTENTIALLY EXEMPT GIFTS

These may become free of IHT over time.

CHARGEABLE GIFTS

These might result in an immediate IHT charge.

EXEMPT GIFTS

MARRIAGE
Married couples can transfer any assets between themselves during their lifetime or on death

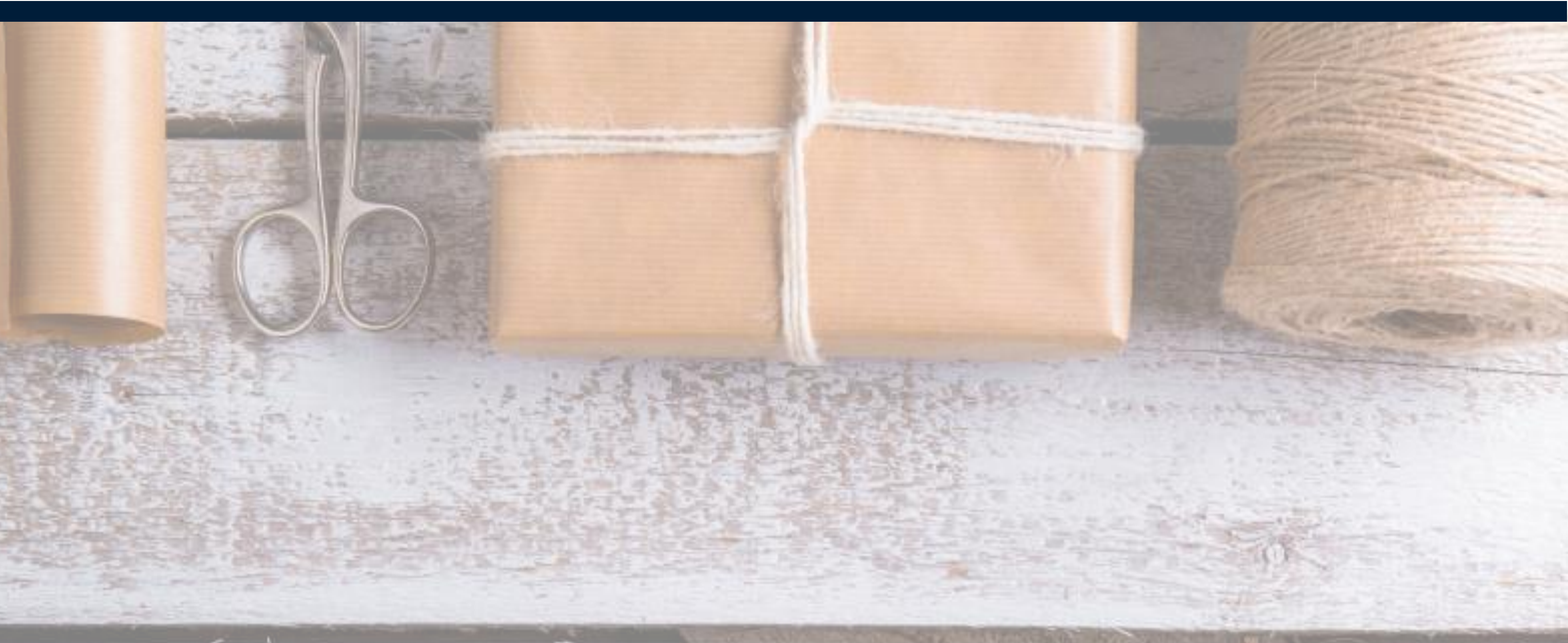
ANNUAL EXEMPTIONS
Each tax year you can gift a total up to £3,000 to one person or it can be split between several people. If you didn't make any gifts one year, you can roll this over to the next year but can only do this once.

SMALL GIFTS
You can gift up to £250 to anyone each tax year, as long as you haven't made any other gifts to the same person in the same year.

FROM INCOME
If you have extra income (after tax) that you don't need, you can make regular gifts.

FOR A WEDDING
You can give your children up to £5,000 and grandchildren or great-grandchildren up to £2,500 when they get married. You can give anyone else up to £1,000.

CHARITIES OR POLITICAL PARTIES
Any donations to these organisations or in your will, are IHT free. If you leave at least 10% of your net estate to charity in your will, the rate of IHT reduces to 36%.



POTENTIALLY EXEMPT GIFTS

Outright gifts that don't fall into one of the exemptions listed will usually be IHT free if you live for seven years or more after making the gift. There is usually no limit to the value of these gifts.

If you don't live for seven years after making the gift, any amount exceeding the £325,000 threshold will be taxed. The tax due is calculated on a sliding scale based on the time between the gift and death. This is known as taper relief and the table below sets out how this works.

TIME BETWEEN GIFT AND DEATH	IHT RATE
Less than 3 years	40%
3-4 years	32%
4-5 years	24%
5-6 years	16%
6-7 years	8%
More than 7 years	0%

The total amount of potentially exempt gifts in the seven years before death falling within the tax-free threshold will reduce it accordingly.

CHARGEABLE GIFTS

A chargeable gift is one that doesn't fall into the above categories, so it may be charged to IHT immediately.

Gifts to a discretionary trust are the most common example. A charge is usually made if the total value of gifts made in a seven-year period exceeds the £325,000 threshold.

RECORD KEEPING

It is important to maintain accurate records to evidence the gifts made.

However, remember your annual exemption!

Where the total value of all gifts you give or receive is no more than £3,000 in a single tax year, you don't need to keep a note of them, although it is still best practice to do so. You can also carry over part or all of your annual IHT exemption into the next year, but no further than that.

INVESTING

Some investments offer IHT savings, however these tend to be higher risk and therefore come with the potential for significant capital loss.

BUSINESS RELIEF (BR)

Shares in certain companies qualify for 100% relief from IHT, meaning there is no IHT to pay on them, however you must have held the shares for at least two years prior to your death to qualify.

Provided that it qualifies, you could pass on a family company, business, unquoted shares or AIM-listed shares on your death, without being subject to an IHT charge. There's no limit on the amount you can transfer.

All investments can go down as well as up, but investment in BR companies can be more volatile and riskier than investing in larger companies and there is a greater risk of getting back less than you invested.

It is important to obtain financial advice before entering into these types of arrangements. They are not suitable for the majority of investments and maybe harder to sell. The tax treatment can change

INVESTING FOR CHILDREN

Investing on behalf of children and grandchildren is a way to give them a great start in life as well as forming part of your IHT planning. Adding money into any of these accounts will help save IHT if it is immediately exempt, or you survive seven years from the date of a potentially exempt gift.

JUNIOR ISAS

You can invest up to £9,000 each year in a tax-efficient account for children under 18. You can invest in either a Cash Junior ISA or Stocks and Shares Junior ISA. The account is free from UK income and capital gains tax. The child can access the money from their 18th birthday.

BARE TRUSTS

These are the simplest type of trust. You can make a gift into an investment account to create a trust. Usually, it is the child who is liable for any tax, so it is rare any tax needs to be paid. However, if this type of gift is made from parents to a child and the gross income exceeds £100 per year, all the income will be taxed as if it were the parents.

JUNIOR PENSIONS

You can invest up to £2,880 into a pension each year for a child and receive 20% tax relief, bringing the total up to £3,600. This can grow free of UK tax and will only be accessible from age 55 (57 from 2028) or possibly later if the rules on pension access change in the future.

The Financial Conduct Authority does not regulate Truss or Tax Planning. The value of tax reliefs depend on your individual circumstances and may change in the future.

One of the simplest things you can do to help your beneficiaries with any inheritance tax liability, is to put a **life insurance policy** in place to provide the funds to pay this after your death.

Normally, you would look at this option, once you have exhausted the other means of reducing or removing any liability, and therefore provider cover based on the estimated outstanding amount or tax to pay.

For a single person this would be a single life policy and for a couple who are married or in a civil partnership and plan to leave everything to each other on first death, this would be a joint life second death whole of life policy. In both instances it would be written in trust for the benefit of those who will eventually inherit the estate.

A whole of life policy is designed to remain in force until the death of the people who are insured, whenever that pay be, and pay out the sum assured of the policy at that point in time.

There are different options for whole of life policies, including those with reviewable premiums and the ability to include an investment element.

When considering reviewable premiums, you should be careful that at the review period, the premiums can increase substantially, or the level of cover can reduce.

The more commonly used options will be a policy with guaranteed premiums, as this will provide you with certainty over the cost of the policy over time.

The premiums for the policy may be quite high depending on the level of cover you require. Depending on the cost, it may not be possible to cover the full liability and depending on your circumstances and other planning you have in place, your estate may increase in value over time leaving a shortfall in cover.

The cost of the premiums will reduce the value of your estate, but their treatment may depend on your circumstances. If you are able to pay them out of your normal income, then they would sit within your normal expenditure allowance. If you fund the premiums from capital, you can either use your annual gifting allowance, or they would be classed as either a potentially exempt transfer or chargeable lifetime transfer, depending on the type of trust arranged.

For pure life insurance contracts premium paid is for the cover itself and rarely has any cash in value.

TRUSTS AND PENSIONS

Trusts can be used to help you save tax and keep control of your assets. You pick the trustees (which can include yourself) who will make decisions like when, and to who, the trust is distributed. You can make gifts into a trust, which are held there until the trustee decides it's time for someone to receive them. The benefit of doing this is so that you can stay in control.

The most commonly used trusts are Discretionary trusts and Bare trusts. Bare trusts (also known as absolute trusts) are the simplest type and are usually set up for a child with one or two adults acting as trustees. The beneficiaries are nominated at outset and cannot be changed. Once they reach 18 (or 16 in Scotland) they are entitled to the trust assets.

With a Discretionary trust, you, or the people you've appointed as trustees, are in control of the money until it is handed over. You can choose who benefits, when and by how much and the money is normally protected from divorce and bankruptcy.

With any trust, the trustees decide where to invest the money and normally any growth or interest will sit outside your estate so you can't benefit from it. The seven-year time frame mentioned elsewhere in this guide starts from the point the money is paid into the trust.

Two other trusts which are commonly used as part of IHT planning are Discounted Gift trusts and Loan trusts.

A Discounted Gift trust provides an immediate IHT saving along with a regular income.

1. A gift is made into the trust, usually of £100,000 or more
2. The gift is split into two parts
3. The first part is treated as a gift and will fall out of the estate after 7 years
4. The second part (the discount) is used to provide income to the investor for life, and is immediately tax free
5. The amount of the discount is based on the age and health of the investor
6. The longer you're expected to live, the greater the discount and the larger the immediate IHT saving

A Loan trust slows down the growth of the value of an estate and the amount of IHT.

1. You loan money to a trust, which is invested
2. As it is a loan, you can get full or partial repayment at any time
3. The outstanding loan amount is always part of your estate
4. But any growth sits outside and is IHT free
5. The loan is set up interest free and regular payments can be made

PENSIONS

Pensions will normally fall outside of the estate; you can name as many beneficiaries as you like and there is no IHT for them to pay. If you die before age 75, and your pensions are below the lifetime allowance (currently £1,073,100) your beneficiaries can usually withdraw what they like from your pension without paying tax.

If you chose to receive an annuity which is paid to a beneficiary after your death, those payments could also be tax free. If you die age 75 or older, withdrawals will be taxed at the beneficiaries' marginal rate of tax.

TAKING FINANCIAL ADVICE

IHT planning is a complex area where thorough planning is needed to make sure you can pass on as much of your estate as possible to your loved ones, without having to compromise your own lifestyle for the rest of your life.

We can help you understand your potential tax liability along with the options available to most effectively mitigate this, based on your own personal circumstances, preferences, and risk profile.

WHY YOUR SHOULD REGULARLY REVIEW YOUR FINANCIAL PLANS

Your financial plans should not be static objects, it is crucial to review your plans over time, and on a regular basis to ensure that you remain on track towards your goals. You also need to adapt your financial plans as your circumstances change.

WHEN SHOULD YOU REVIEW YOUR FINANCIAL PLAN?

This can depend on your circumstances, but it should certainly be at least annually, and probably also when something major happens to your personal or financial situation.

Having an expert on hand to support you with your investment decisions is the best thing you can do for your own peace-of-mind.

Safehands Independent Financial Advisers Limited
St George House
29 St George Road
Cheltenham
Gloucestershire
GL50 3DU

Tel: 01242 516784

Email: enquiries@safehandsifa.co.uk

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Although endeavours have been made to provide accurate information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. We cannot accept responsibility for any loss as a result of acts or omissions taken in respect of any articles.

Tax reliefs are subject to change and their value depends upon your individual circumstances.

Investments carry risk. The value of your investments (and income from them) can go down as well as up, and you may get back less than you invested. Past performance is not a reliable indicator of future results. Investments should be considered over the longer term and should fit in with your overall attitude to risk and financial circumstances.

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Registered office: St George House, 29 St Georges Road, Cheltenham, Gloucestershire, GL50 3DU