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Navigating Inheritance Tax

How to pass on assets to the next generation to secure their future for tomorrow

Inheritance Tax (IHT) represents a significant consideration for anyone looking to pass on assets to the next generation. As of the 2024/25 tax year, IHT incurs a 40% charge on the portion of an estate exceeding the nil rate band of £325,000, excluding transfers to a spouse or registered civil partner.

Additionally, the introduction of the main residence allowance in 2017, offering an extra £175,000 relief when a primary residence is bequeathed to direct descendants or where an individual has moved into a care home, enables individual allowances to reach £500,000 before IHT applies cumulatively.

However, this allowance diminishes for estates valued above £2 million and comes with specific conditions, highlighting the importance of proactive IHT planning. With the IHT threshold frozen until at least April 2028, understanding how to manage your estate's potential IHT liability is more crucial than ever.

EFFECTIVE ESTATE PLANNING STRATEGIES

A cornerstone of estate management and IHT management involves maximising the use of gift allowances. The law permits unlimited transfers between UK-domiciled spouses or registered civil partners without incurring IHT. For gifts to others, the annual exemption allows you to give away up to £3,000 per tax year, potentially carrying forward any unused allowance to the next year, enabling a £6,000 gift.

Further opportunities for IHT-free gifting include small gifts of up to £250 per person annually, donations to qualified charities and institutions, and wedding gifts within certain monetary limits, depending on your relationship with the couple. These strategies reduce your taxable estate and allow you to see your beneficiaries enjoy their inheritance during your lifetime.

REDUCING ESTATE VALUE THROUGH INCOME GIFTING

Another straightforward method to minimise your estate's IHT exposure is to gift excess income. This approach requires that gifts do not affect your standard of living, originate from surplus income rather than capital and be made regularly.

You can significantly lessen the future IHT burden by redistributing income that would otherwise increase your estate's value. Moreover, such surplus income could be channelled into funding a life assurance policy within a trust, providing further financial efficiency and peace of mind.

ASSET GIFTING CONSIDERATIONS

Gifting assets such as cash, art and property presents a viable strategy for reducing your future taxable estate's value. It's imperative, however, that once gifted, you derive no benefit from these assets to avoid them being classified as 'gifts with reservation', which could negate any IHT benefits.

Furthermore, to qualify as 'potentially exempt transfers', the '7-year rule' means you must survive for seven years following the gift. Failure to do so may result in the gifts being subject to IHT. Given the complexity of trusts, professional advice is prudent when considering gifts into trust, typically treated as chargeable lifetime transfers.

TAPER RELIEF

Years between gift and death	Rate of tax on the gift
3 to 4 years	32%
4 to 5 years	24%
5 to 6 years	16%
6 to 7 years	8%
7 or more	0%

MITIGATING INHERITANCE TAX THROUGH INSURANCE

Securing against potential IHT liabilities can be achieved effectively through insurance, especially for assets that are not easily transferred into trusts or gifted, such as real estate. Opting for a 'whole of life' assurance policy can serve as a strategic approach, ensuring a predetermined sum is available to settle any IHT due upon death.

Notably, if these premiums are financed using surplus income or within the £3,000 annual gift exemption, they evade classification as chargeable lifetime transfers. The policy must be placed in an appropriate trust to ensure the proceeds do not augment the value of the estate and thus remain outside the scope of IHT.

STRATEGIC INVESTMENT IN BUSINESS RELIEF

In addition to insurance, investing in assets eligible for Business Relief (BR) presents a viable method for reducing IHT liability. Such assets once held within an IHT portfolio for a minimum of two years—and assuming ownership at the time of death—are subject to 0% tax. This encompasses a range of unlisted companies and certain AIM-listed stocks.

While this strategy introduces a greater degree of investment risk compared to other avenues, it offers the distinct advantage of retaining access to your capital without the necessity to survive an additional seven years, as is typically required. However, it is essential to acknowledge that this form of investment, predominantly in small capitalisation equities, is considered high risk due to the inherent volatility and uncertainty of growth, making it a long-term commitment.

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IMPORTANCE OF PROFESSIONAL GUIDANCE

Given the speculative nature of investments focused on small capitalisation and AIM-listed stocks, potential investors should proceed with caution. The possibility of substantial fluctuations underscores the need for such investments to be viewed with a long-term perspective. Furthermore, the regulatory landscape governing IHT and the tax treatment of specific investment vehicles, like AIM shares, could evolve, potentially affecting their suitability as part of an IHT mitigation strategy.

Therefore, obtaining professional financial advice is indispensable. Tailoring financial strategies to individual circumstances and maximising the efficacy of available tax reliefs demands a comprehensive understanding of current regulations and personal financial objectives. Efficiently managing your estate to mitigate IHT liabilities requires careful planning and a thorough knowledge of the available allowances and exemptions. ■

ARE YOU LOOKING FOR TAILORED ADVICE TO SECURE YOUR LEGACY?

If you require further information or wish to discuss tailored estate planning solutions, we are ready to provide you with the guidance and support needed to navigate the complexities of Inheritance Tax planning. Contact us today to secure your legacy for tomorrow.

THIS ARTICLE DOES NOT CONSTITUTE TAX OR LEGAL ADVICE AND SHOULD NOT BE RELIED UPON AS SUCH. TAX TREATMENT DEPENDS ON THE INDIVIDUAL CIRCUMSTANCES OF EACH CLIENT AND MAY BE SUBJECT TO CHANGE IN THE FUTURE. FOR GUIDANCE, SEEK PROFESSIONAL ADVICE.

THE FINANCIAL CONDUCT AUTHORITY DOESN'T REGULATE TRUST PLANNING AND MOST FORMS OF INHERITANCE TAX (IHT) PLANNING. SOME IHT PLANNING SOLUTIONS PUT YOUR MONEY AT RISK, AND YOU MAY GET BACK LESS THAN YOU INVESTED. IHT THRESHOLDS DEPEND ON INDIVIDUAL CIRCUMSTANCES AND THE LAW. TAX AND IHT RULES MAY CHANGE IN THE FUTURE.

THE VALUE OF YOUR INVESTMENTS CAN GO DOWN AS WELL AS UP, AND YOU COULD GET BACK LESS THAN YOU INVESTED.