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Protecting family wealth

Start planning your legacy to mitigate or reduce Inheritance Tax

If you've worked hard throughout your lifetime to grow your wealth, you may hope it will help to safeguard the financial security of your loved ones after you've gone. But without careful planning in your lifetime, you could leave them with less than expected after the Inheritance Tax bill is paid.

Proper planning can help you pass on as much as possible to the people you choose by avoiding additional unnecessary tax charges. But there is a perception by some people that Inheritance Tax only affects the rich, which is untrue.

CURRENT AND FUTURE NEEDS OF YOUR LOVED ONES

When you're getting on with life, it's not easy to stop and think about what will happen to your estate (such as your property, possessions, investments and cash) when you're no longer around. That's why it's important to make sure that any assets you've built up over your lifetime aren't subject to Inheritance Tax unnecessarily after your death, and that your loved ones, and any organisations close to your heart, benefit from your estate as you intended.

By reviewing your wealth and obtaining professional financial advice, you will be able to consider the current and future needs of your loved ones and how you can benefit them whilst preserving your assets.

INHERITANCE TAX FACTS

Every individual has an Inheritance Tax 'nil-rate band' of £325,000 in the current 2021/22 tax year (the UK tax year starts on 6 April each year and ends on 5 April the following year). This means that you can pass on up to £325,000 worth of property, money and other assets with no Inheritance Tax to pay.

Above this threshold, Inheritance Tax is normally levied at 40%. So, as a simple example, if you were to pass on wealth of £425,000, the first £325,000 would be tax-free, and the remaining £100,000 would be taxed at 40%, creating a tax liability of £40,000 for your personal representatives to pay out of your estate, therefore leaving less for the recipients of your estate.

However, there are many tax reliefs and rules that can minimise the amount of Inheritance Tax due. You can leave your entire estate to a surviving spouse or registered civil partner with no Inheritance Tax due. But there are many other, lesser-known rules and reliefs that can also apply.

The current Inheritance Tax nil-rate bands will remain at existing levels until April 2026.

HOW INHERITANCE TAX PLANNING WORKS

Inheritance Tax planning is a way of arranging your wealth with the various tax reliefs in mind so that your loved ones don't pay more tax than they legally need to.

It works best when the process is started many years in advance. Certain transfers of capital may only become free from Inheritance Tax if you survive for seven years after they are made, so Inheritance Tax planning cannot be rushed.

Of course, Inheritance Tax is not the only consideration when it comes to arranging your

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finances – you also need to ensure that your wealth works for you in your lifetime. So, this planning must work in harmony with other areas of financial planning. It's a precise and personal process.

THREE STEPS TO MITIGATE OR REDUCE INHERITANCE TAX

The rules and reliefs that are most beneficial to you depend on your personal and financial situation. The advice you receive will be different based on whether you're single or married, if you have children or grandchildren, if you own your own business, or on many other factors.

That said, here are three tips that many people could benefit from.

1. THE RESIDENCE NIL-RATE BAND (RNRB)

As well as the Inheritance Tax nil-rate band mentioned earlier, there is an additional nil-rate band that applies when passing on a property that was your main residence in your lifetime. This is an additional Inheritance Tax-free allowance for 'qualifying' home owners with estates worth less than £2.35 million (where one residence nil-rate band is available) or £2.7 million (where two residence nil-rate bands are available), that can result in you being able to pass on up to £500,000 when you die before Inheritance Tax has to be paid using the nil-rate band and residence nil-rate band.

If you leave a property that has been your main residence at some point, to a direct descendant (which includes a child, adopted child, stepchild, foster child, grandchild or great-grandchild), you'll qualify for the residence nil-rate band, which is currently £175,000. So, by using both nil-rate bands, the total tax-free portion of your estate will be £500,000.

If you are a surviving spouse who inherited the total estate of your deceased partner, you also inherit their nil-rate bands. So, in this scenario, you would be able to pass on up to £1,000,000 free of Inheritance Tax (including £350,000 of property using the RNRB capped at the property value if less) and a further £650,000 of your combined estate). This assumes the estate on both first and second deaths wasn't over £2 million.

2. LIFETIME GIFTS

One way to minimise your Inheritance Tax bill is by gifting money or assets during your lifetime rather than waiting to pass on your wealth until after your death. However, in some situations, a gift can create an Inheritance Tax liability.

To be sure that yours doesn't, follow these rules:

- Small gifts (up to £250) to different individuals are typically free from Inheritance Tax. This rule is intended to cover any birthday gifts, Christmas gifts, etc.
- Larger gifts are free from Inheritance Tax up to a total of £3,000 in each tax year. If you don't use your total allowance in one tax year, you can carry it forward to the next year as long as you also use up the current year allowance.
- Wedding (or registered civil partnership) gifts are free from Inheritance Tax up to a certain value, which depends on your relationship to the recipient. If you are their parent, the limit is £5,000. If you are a grandparent or great-grandparent, the limit is £2,500. In any other case, the limit is £1,000.
- Regular gifts out of income – unlimited amounts as long as made regularly out of surplus income such that standard of living isn't affected.

3. A DEED OF VARIATION

In some cases, you might have carefully arranged your wealth for Inheritance Tax purposes, but you then inherit money or other assets in someone's Will that would result in your estate exceeding your available nil-rate bands.

Rather than accepting this inheritance (which you may not need and would likely leave to a loved one later), you could execute a Deed of Variation so that it is passed directly to that loved one immediately. It will not be counted as part of your estate. ■

WHAT WILL YOUR LEGACY LOOK LIKE?

To learn more about Inheritance Tax planning and find out which rules and reliefs could benefit you, we would be pleased to discuss your circumstances and make recommendations based on your needs. If you would like to discuss your situation, please contact us for more information.