Grayside Financial Services
1st Floor, 55 High Street,
Epsom, Surrey KT19 8DH
Tel: 01372 726 162 **Fax:** 01372 724 988
Email: enquiries@grayside.co.uk

GRAYSIDE
FINANCIAL SERVICES

FACTSHEET

Protecting your estate for future generations

Many individuals find the Inheritance Tax rules too complicated

If you struggle to navigate the UK's Inheritance Tax regime, you are not alone. Whether you are setting up your estate planning or sorting out the estate of a departed family member, the system can be hard to follow. Getting your planning wrong could also mean your family is faced with an unexpectedly high Inheritance Tax bill.

RELUCTANT TO SEEK PROFESSIONAL ADVICE

Findings from a recent survey[1] revealed that over three quarters (77%) think the UK's Inheritance tax rules are too complicated. Yet despite this, only a third (33%) have sought professional advice on Inheritance Tax planning.

We understand that ensuring your Inheritance Tax planning is tax-efficient is a sensitive subject, and as a result planning opportunities can be missed. Early preparation is the key to success. Taking advantage of alternative methods to secure wealth and to shelter your estate will ensure that more wealth can be passed onto the next generation.

EXEMPT FROM INHERITANCE TAX

Every individual in the UK, regardless of marital status, is entitled to leave an estate worth up to £325,000. This is known as the 'nil-rate band'. Anything above that amount is taxed at a rate of 40%. If you are married or in a registered civil partnership, then you can leave your entire estate to your spouse or partner. The estate will be exempt from Inheritance Tax and will not use up the nil-rate band.

Instead, the unused nil-rate band is transferred to your spouse or registered civil partner on their death. This means that should you and your spouse pass away, the value of your combined estate has to be valued at more than £650,000 before the estate would face an Inheritance Tax liability.

Here's our snapshot of the main Inheritance Tax areas you may wish to consider and discuss further with us.

STEPS TO MITIGATE AGAINST INHERITANCE TAX

MAKE A WILL

Dying intestate (without a Will) means that you may not be making the most of the Inheritance Tax exemption which exists if you wish your estate to pass to your spouse or registered civil partner. For example, if you don't make a Will, then relatives other than your spouse or registered civil partner may be entitled to a share of your estate, and this might trigger an Inheritance Tax liability.

RESIDENCE NIL-RATE BAND (RNRB)

If you're worried that rising house prices might have pushed the value of your estate into exceeding the nil-rate band, then the new 'residence nil-rate band' could be significant. Introduced in 2017, it can be claimed on top of the existing nil-rate band. It is £125,000 (2018/19) and will increase annually by £25,000 every April until 2020, when the £175,000 maximum is reached.

The RNRB is only available where a property that is (or was) used as the deceased's main residence is passed to a direct descendant. From 6 April 2021, the RNRB will then increase each tax year in line with CPI. The RNRB is also

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transferable between married couples and civil partners to the extent that it is not used on first death. The RNRB is tapered by £1 for every £2 when a total estate is worth over £2 million.

MAKE LIFETIME GIFTS

Gifts made more than seven years before the donor dies, to an individual or to a bare trust (see types of trust), are free of IHT. So it might be wise to pass on some of your wealth while you are still alive. This will reduce the value of your estate when it is assessed for IHT purposes, and there is no limit on the sums you can pass on. You can gift as much as you wish – this is known as a 'Potentially Exempt Transfer' (PET).

If you live for seven years after making such a gift, then it will be exempt from Inheritance Tax. However, should you be unfortunate enough to die within seven years, then it will still be counted as part of your estate if it is above the annual gift allowance. You need to be particularly careful if you are giving away your home to your children with conditions attached to it, or if you give it away but continue to benefit from it. This is known as a 'Gift with Reservation of Benefit'.

LEAVE A PROPORTION TO CHARITY

Being generous to your favourite charity can reduce your Inheritance Tax bill. If you leave at least 10% of your estate to a charity or number of charities, then your Inheritance Tax liability on the taxable portion of the estate is reduced to 36% rather than 40%.

SET UP A TRUST

Family trusts can be useful as a way of reducing Inheritance Tax, making provision for your children and spouse, and potentially protecting family businesses. Trusts enable the donor to control who benefits (the beneficiaries) and under what circumstances, sometimes long after the donor's death. Compare this with making a direct gift (for example, to a child) which offers no control to the donor once given. When you set up a trust, it is a legal arrangement, and you will need to appoint 'trustees' who are responsible for holding and managing the assets. Trustees have a responsibility to manage the trust on behalf of and in the best interest of the beneficiaries, in accordance with the trust terms. The terms will be set out in a legal document called 'the trust deed'.

TYPES OF TRUST YOU MIGHT CONSIDER

BARE (ABSOLUTE) TRUSTS

The beneficiaries are entitled to a specific share of the trust, which can't be changed once the trust has been established. The settlor (person who puts the assets in trust) decides on the beneficiaries and shares at outset. This is a simple and straightforward trust – the trustees invest the trust fund for the beneficiaries but don't have the power to change the beneficiaries' interests decided on by the settlor at outset. This trust offers potential Income Tax and Capital Gains Tax benefits, particularly for minor beneficiaries. However, it should be borne in mind that if a parent creates a bare trust for their minor unmarried child – and the gross income is more than £100 a year – under the 'parental settlement' rules, all the income will be taxed on the parent.

LIFE INTEREST TRUSTS

Typically, one beneficiary will be entitled to the income from the trust fund whilst alive, with capital going to another (or other beneficiaries) on that beneficiary's death. This is often used in Will planning to provide security for a surviving spouse, with the capital preserved for children. It can also be used to pass income from an asset on to a beneficiary without losing control of the capital. This can be particularly attractive in second marriage situations when the children are from an earlier marriage.

DISCRETIONARY (FLEXIBLE) TRUSTS

The settlor decides who can potentially benefit from the trust, but the trustees are then able to use their discretion to determine who, when and in what amounts beneficiaries do actually benefit. This provides maximum flexibility compared to the other trust types, and for this reason is often referred to as a 'Flexible Trust'. ■

TIME TO EVALUATE WHETHER OR NOT INHERITANCE TAX COULD BECOME PAYABLE?

When someone dies, Inheritance Tax needs to be considered. Without the right professional advice and careful financial planning, HM Revenue & Customs can become the single largest beneficiary of your estate following your death. To evaluate whether or not Inheritance Tax could become payable, all of your assets you hold at the date of death need to be valued, and reliefs and exemptions determined. Don't leave it to chance – contact us for a review of your situation.

Source data:

[1] Canada Life's annual Inheritance Tax monitor survey of 1,001 UK consumers aged 45 or over with total assets exceeding the individual Inheritance Tax threshold (nil-rate band) of £325,000. Carried out in October 2017.

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