Keeping it in the family
How to reduce an inheritance tax bill
In this guide we explain:

• How inheritance tax works

• Why you need an up-to-date will

• The value of gifting assets during your lifetime

• The most tax-efficient form of home ownership

• How pensions can be used as an estate planning tool

• The benefits of using trusts

• When Business Relief and Enterprise Investment Schemes could be appropriate.
Inheritance tax raised a record £4.9bn in the last financial year\(^1\), the highest amount since the current tax system was introduced 31 years ago. This is more than double the annual amount paid in inheritance tax (IHT) in the 2009-10 tax year, when IHT netted £2.3bn.\(^1\)

The dramatic increase in the IHT haul in recent years has mainly been the result of rising property prices and frozen tax thresholds. But, it is also a consequence of many families failure to plan.

Many people think it is deeply unfair that the estate they have worked so hard to build up can potentially be subject to a 40% tax charge.

Fortunately, there are lots of exemptions that can help mitigate the tax paid. Regrettably, many families fail to take full advantage of what is on offer.

Brewin Dolphin commissioned Opinium to looks at trends in inheritance in recent years. It found that almost half of UK adults have never discussed passing on their legacy.\(^2\)

Many find the idea of discussing inheritance uncomfortable. People wrongly assume that IHT planning must be complicated. Their reticence means that IHT planning is put off until the last minute, by which time it may be too late to make a difference.

At Brewin Dolphin, we believe this is an opportunity lost. Our experts can work with you to ensure you make use of all the reliefs and exemptions you can. We can build a tailor-made succession plan based on your individual circumstances to make sure the allowances work best for you.

We can give you the peace of mind of knowing that you have laid the firmest foundations for your family’s future.

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2. Brewin Dolphin research, August 2017. Opinium surveyed 4,012 adults online between 11 and 17 August 2017, 47% have never discussed inheritance.
Why you should consider IHT planning

Whenever someone dies the value of their estate becomes liable for IHT. If you are domiciled in the UK, your estate includes everything you own, including your home and certain trusts in which you may have an interest.

However, everyone is entitled to pass on assets of up to £325,000 IHT free. This is called the nil-rate band. Married couples and registered civil partners can share their thresholds, transferring the unused element of their IHT-free allowance to their living spouse when they die. Doubling up the relief means a married couple or registered civil partnership have a joint nil-rate band of £650,000.

The new residence allowance

In April 2017 an extra allowance was introduced when a residence is passed to a ‘direct descendant’. This is known as the residence nil-rate band (RNRB), and like the standard nil-rate band unused elements of the allowance are transferable to a surviving spouse or registered civil partner.

In the 2017-18 tax year, the RNRB is £100,000 per person. This means a married couple with children can pass on a maximum of £850,000 in total without having to pay IHT – two lots of £325,000 (£650,000) and two lots of £100,000 (£200,000). Any excess over this amount is then taxed at 40%.

The RNRB will rise in steps to £175,000 in April 2020, at which point couples will be able to leave up to £1m tax free when they die.

The “voluntary tax”

On top of the nil-rate bands there are a range of reliefs and exemptions that with careful planning can be used to reduce an IHT bill. The former home secretary, Lord Jenkins of Hillhead, called IHT “a voluntary tax, paid by those who distrust their heirs more than they dislike the Inland Revenue.”

However, the research we conducted with Opinium suggests that many families failure to plan for IHT is more a matter of reticence than distrust. Key findings include:

- More than a third of people (36%) don’t feel comfortable talking about their legacy.
- One in seven (14%) said they haven’t discussed the subject with loved ones because they don’t like talking about death.
- A health scare (52%), a near death experience (46%) and getting older (46%) are most likely to prompt people to talk to loved ones about this important subject.

47% of UK adults have never discussed passing on their legacy.
• After their partner and spouse (32%), people feel most comfortable talking to their mum (8%) or a financial adviser (8%) in the first instance.

If you want to pass on as much of your wealth as possible, talking about inheritance is a vital first step. Once you have started the discussion, creating an estate plan to suit your needs does not have to be difficult. Over the next pages we explain the options available and how we can help you establish your own succession plan.

Making estate planning work for you

**Step 1: First, think will**

Before you move on to any other forms of estate planning it is essential that you have an up-to-date will. Making a will is one of the most important things you can do to ensure your estate goes to who you want and that your wishes are carried out.

Even if you already have a will you might need to take action. For example, you might need to revisit your will to benefit from the residence nil-rate band. The new relief will only be available if assets are left directly to descendants. As a lot of older wills hold assets in trust you could lose out if your will is not updated.

We strongly recommend you take legal advice to make sure your wishes are met and your wills are as tax-efficient as possible. Many people set up mirror wills with their spouse, which means that they leave their estate to the other in the event of their death. However, it might make more sense to make a will that transfers some assets to children or grandchildren after the death of the first spouse. It depends on your circumstances.

**Step 2: Lifetime gifts – start with the simple things**

Most people wait until death before passing on their wealth through their wills. However, it can be more tax-efficient for IHT purposes to gift money while you are still alive.

Transferring wealth while you are alive can have a transformative effect on both your and your family’s life. Gifting money to a younger relative to top up their pension can substantially boost their income when they eventually retire. And paying into an ISA for a youngster can provide them with a useful financial head start in life. Half of people say that their main incentive for making lifetime gifts is a desire to watch loved ones benefit from their wealth.³

- Each year you can give away £3,000 and that gift will not be subject to IHT.
- You can also give £250 to any number of people each year.
- Parents can give £5,000 to each of their children as a wedding gift. Grandparents can give £2,500 and anyone else £1,000.

Gifts of any size to charities or political parties, are also tax free. If a gift is regular, comes out of your income and does not affect your standard of living, any amount of money can be given away and ignored for IHT.

It is possible to make further tax-free gifts – potentially exempt transfers – but you have to survive for seven years after making the gift to get the full benefit of it being outside of your estate for IHT purposes.

If you pass away within seven years and the gifts are valued at more than the nil-rate band, taper relief will be applied. The tax reduces on a sliding scale if the gift was made between three and seven years earlier (see Chart 1).
### Chart 1 - Taper relief rates

<table>
<thead>
<tr>
<th>Number of years between gift and death</th>
<th>Tax paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-3</td>
<td>40%</td>
</tr>
<tr>
<td>3-4</td>
<td>32%</td>
</tr>
<tr>
<td>4-5</td>
<td>24%</td>
</tr>
<tr>
<td>5-6</td>
<td>16%</td>
</tr>
<tr>
<td>6-7</td>
<td>8%</td>
</tr>
<tr>
<td>7 or more</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: Gov.UK: Inheritance Tax
Step 3: Consider how you own your home

Typically couples own their home as joint tenants. If one partner dies, the other automatically becomes the sole owner of the property.

This works for many couples, but for some it makes more sense to be tenants in common. This means they each own a set share of the home. This can be half each, or a defined percentage. This enables each partner to pass on a share of their home on death to someone other than their spouse – their children, for instance.

This can help reduce an IHT bill and long-term care costs. However, it’s a complicated decision, so you should seek advice from legal and tax experts before changing the way you own your home.

Step 4: Make use of pensions

Pensions are one of the most tax-efficient ways to pass on your wealth. If you pass away before the age of 75, benefits left in a money purchase pension can be paid as a lump sum or drawdown income to any beneficiary, with absolutely no tax to pay. After the age of 75 they will be taxed at the beneficiaries’ marginal income tax rate.4

It might make sense to use other investments, such as individual savings accounts, to provide a retirement income and retain funds in your pension for as long as possible.

As long as the funds remain in drawdown they will remain IHT free. This means you can pass your pension on to your children, and then they can pass it on to their children who in turn can pass it to their offspring, raising the prospect of pension money cascading down the generations.

Step 5: Take control with trusts

Trusts can reduce an IHT bill and give you control over how your assets are used by future generations.

Trusts can help you:

- Keep a lump sum outside of your survivor’s estate to ensure it is not subject to IHT
- Protect your children/grandchildren’s legacy if your surviving spouse remarries
- Protect your children/grandchildren’s legacy from their own marital disputes
- Avoid giving children/grandchildren a sum of money that they may not spend as wisely as you would like.

Trusts can be a complex matter. For example, if you die within seven years of making a transfer into a trust your estate will have to pay IHT at the full amount of 40%.5 We can make a referral to a legal professional to assist you.

**Step 6: Don’t forget life assurance**

Life assurance can be used to either meet, or reduce a prospective IHT bill. You set up a whole-of-life assurance policy, which lasts for as long as you live.

As long as the policy is written in trust, the proceeds of the life assurance policy will not be included in your estate. When you die the policy pays out to the trust which pays all or part of the inheritance tax bill.

**Step 7: Think about discounted gift trusts**

An alternative option, if you are able to give up capital, is a discounted gift trust. These are designed for people who want to gift money to a trust, draw a regular income for the rest of their life and then pass what is remaining of the gift to their heirs free of IHT.

The trust purchases an investment bond, which provides a tax-efficient income of up to 5% until your death. If you survive for seven years, the bond does not count as part of your estate.

Even if you died within seven years your heirs would receive a discount on the IHT because your right to draw an income from the gift reduces its value.

**Step 8: Further planning opportunities**

A number of shares listed on the Alternative Investment Market, or AIM, become free from IHT once you have held them for two years because they qualify for Business Relief (BR).

You need to take care as there are strict rules on what qualifies and investing in AIM stocks can be risky. However, we can recommend schemes that have a track record of managing successful portfolios of assets that qualify for BR.

Enterprise Investment Schemes (EISs) also benefit from BR, meaning there is no IHT to pay on investments once you have held them for two years.

EISs, which invest in small, high-risk unquoted enterprises, offer a number of tax advantages. There is upfront income tax relief of 30%, and, provided the investment is held for three years, there is no capital gains tax to pay when the EIS is eventually sold.

If capital gains on another asset are realised, the tax can be deferred by reinvesting them in an EIS. If the EIS is held until death, the deferred gain is wiped out and never chargeable.

EISs are very high-risk. There is the danger that you could lose a large part, or even all, of your capital. As they are illiquid assets they can also be difficult to sell. Before you invest, talk to our financial planners who can help ensure your investment strategy is appropriate to your risk profile.
How we can help you

Estate planning is a complex area that is subject to regular regulatory change. But, our financial planners can help you create a succession plan best suited to your family’s circumstances.

If you have a very large and complicated estate, the sooner you start planning the better. For many people, though, an opportune time to establish an IHT plan is soon after retirement.

An efficient IHT plan involves gifting assets during your lifetime. However, you don’t want to give away money that you will later need. You are likely to have a clearer idea of your potential financial needs in retirement once you have given up work.

Our planners can work with you to establish what you want to do with your money now and what you might need in the future, for example, to cover care needs in later life. Once you have clarity about what you require, you can establish how much wealth is left to pass on to future generations.

If you would like to discuss any of the issues raised in this guide please call 020 3201 3900 or contact your local Brewin Dolphin office.
The value of investments and any income from them can fall and you may get back less than you invested.

Please note that this document was prepared as a general guide only and does not constitute tax or legal advice. While we believe it to be correct at the time of writing, Brewin Dolphin is not a tax adviser and tax law is subject to frequent change. Tax treatment depends on your individual circumstances; therefore you should not rely on this information without seeking professional advice from a qualified tax adviser.

No investment is suitable in all cases and if you have any doubts as to an investment’s suitability then you should contact us.

The information contained in this document is believed to be reliable and accurate, but without further investigation cannot be warranted.