Larking Gowen

Committed to you.

Simple ways to mitigate inheritance tax

Who's affected?

Inheritance tax (IHT) is a tax on the value of assets transferred by individuals during their lifetime or on death. It's relevant to anyone with assets worth over £325,000.

We can give you the support and advice you need to mitigate the impact of inheritance tax and make sure that as much of your wealth as possible is preserved.

We have a specialist department dealing with personal taxation and trusts. Many have found that our effective tax planning reduces their overall tax burden whilst taking into account family circumstances.

How to mitigate IHT

Make gifts out of surplus income

If you have income in excess of your expenditure, you can give it away IHT free, provided that you're able to maintain your usual standard of living.

It's important that you don't give away more than you can afford and that you keep careful income and expenditure records, which comply with HM Revenue & Customs' (HMRC) expectations.

Use your exemptions

Exemptions are amounts you can give away tax free.

Annual exempt amount: Individuals can make gifts of up to £3,000 in total per year, tax free. This exemption can be carried forward for one tax year, if it's not used.

Gifts on marriage: Gifts in contemplation of marriage are exempt, depending on your relationship with the parties to the marriage. Up to £5,000 of a gift to children on marriage is exempt; to other family members, up to £2,500; and to other people, up to £1,000.

Small gifts: You can also give up to £250 to any one person, per year, tax free. This exemption cannot be used in conjunction with the annual exemption of £3,000.

Charities/political parties: Gifts to charities and political parties are completely exempt from IHT. This applies to both lifetime gifts and bequests by will on death.

Spousal exemption: Gifts to your UK-resident and domiciled spouse or civil partner are IHT free without limit.

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How to mitigate IHT

Make lifetime gifts

Outright gifts to individuals are known as "potentially exempt transfers" (PETs) and are IHT free if the donor survives the gift by seven years.

If you die before the seven-year period is up, any PETs you have made become chargeable (but taper relief will apply if you survive for at least three years).

Taper relief is a sliding scale relief against IHT due on gifts made within seven years of death.

Issues such as the stability of the relationships of the recipient of the gift (the "donee") and also their financial position should be considered before making outright gifts.

Such gifts can be taken into account in divorce and bankruptcy settlements, as well as an individual's entitlement to some means-tested state benefits.

We recommend that you read the Law Society's guidance notes on making gifts, available from us on request, which covers the pros and cons in much more detail.

Use your pension

Make sure that you nominate someone to receive the death benefits associated with your pension or arrange for them to go into a trust, so that they can pass tax free on your death.

Following recent changes to the way inherited pensions are taxed, it's now possible to use your pension pot itself to mitigate IHT.

> "If you're considering making lifetime gifts, think carefully whether this will leave you with enough funds to live comfortably for the rest of your life."

Invest in exempt assets

Business and agricultural assets usually qualify for relief (within strict parameters). This includes qualifying shares on the Alternative Investment Market (AIM), amongst others. Many investment managers are happy to advise on them.

Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) investments are also usually exempt from IHT, provided that they have been owned for at least two years.

Make a tax-efficient will

A well-drafted will can save IHT on your death and ensure that you make adequate provision for those who need it, such as dependants and vulnerable beneficiaries. This can be achieved by maximising the allowances and reliefs available on death and by using trusts for added flexibility.

Use your nil rate band

Every individual has a nil rate band. This is the amount you can give away before IHT is payable.

Individuals are entitled to a nil rate band (currently £325,000) every seven years.

So if you want to make chargeable transfers (as opposed to PETs) by, for instance, transferring assets into trust, you can give away £325,000 (at current rates) every seven years tax free. Anything over that is taxed at 20%.

Trusts can be a means of protecting assets from being squandered by the donee and offer a degree of protection in divorce and bankruptcy.

Trusts can be drawn flexibly to allow a wide range of beneficiaries (including charities) to benefit and you can be a trustee if you prefer to keep an element of control.

Family investment companies are an alternative to trusts or can be used in conjunction with trusts, depending on the circumstances. They are tax-efficient vehicles offering protection and control, allowing growth in wealth to be passed on to future generations, tax free.

A brochure about family investment companies is available on request.

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