Tax Planning Tips

Estate planning – handing on your wealth

Plan to maximise your inheritance tax (IHT) nil rate band on death

Everyone has a nil rate band of £325,000 on which no IHT is charged. If you have children, or step-children, you can add up to £175,000 (known as the residence nil rate band) to your nil rate band by leaving your home to one or more direct descendants on your death, or to certain types of trust. Your Will needs to make it clear who should inherit the home. This extra relief is restricted to the net value of the home, after deduction of any mortgage. It is also restricted where your estate is worth over £2 million on death. It may be worth paying down a mortgage or making some lifetime gifts to reduce the value of your estate below £2 million. The total value of the nil rate band is fixed until at least 6 April 2028.

Long deceased spouses can help save IHT today

Widows and widowers inherit the unused proportion of their late spouse's or civil partner's nil rate band for IHT – even if they died many years ago. This could mean that up to an extra £325,000 of the estate will be tax free. The residence nil rate band (see above) is also inheritable, regardless of when the first spouse died.

Example
Mia's estate is valued at £950,000 for IHT purposes. The estate includes her main residence valued at £300,000, but this is bequeathed to Mia's brother, rather than to her two children (who inherit the remainder of the estate). Mia's husband died five years ago, without using any of his nil rate band or residence nil rate band. Currently, IHT of £120,000 (£300,000 at 40%) will be payable in respect of Mia's estate on her death, but if Mia changes her will so that her children inherit her main residence, the IHT payable will be reduced to nil.

Make a Will and tell people about it

If you die with no surviving relatives and you haven't made a Will, the intestacy rules mean that the whole of your estate will go to the government. That's 100% tax. If you want your relatives, friends and favourite charities (see below) to benefit on your death, make a Will and ensure it can be found after you die. If you have a surviving spouse or civil partner, they may only get a portion of your estate if a Will can't be found after your death. The residue will then be subject to IHT at 40% to the extent that it exceeds £325,000 (up to £500,000 if the residence nil rate band is available).

Cut your IHT rate by leaving gifts to charity in your Will

By writing your Will so that at least 10% of your net estate is left to charities, the IHT on the remainder of your taxable estate will be charged at 36% instead of 40%. The exact calculation of your net estate is complex, so take professional advice when drawing up or amending your Will.

Legalise your relationship to save IHT

Being married or in a civil partnership will save IHT as your spouse/civil partner can inherit any amount from you tax free, as long as they are UK domiciled. This tax exemption doesn't apply if you are not legally married to your partner. Your surviving spouse/civil partner can also inherit your unused nil rate band and residence nil rate band (together worth up to £500,000), which will save further IHT payable on their own death.

Make regular IHT-free gifts out of your annual income

Regular gifts out your net income are free of IHT provided the gifts don't change your normal standard of living or reduce your capital assets. The amounts of the gifts and/or the recipients can be different each year.

Example
Rebecca pays the quarterly gas and electricity bills of her niece and nephew out of her surplus net income. These regular gifts are free of IHT as they do not affect Rebecca's lifestyle or eat into her capital assets.

Use your IHT-free gift allowances

In addition to regular gifts out of your net income (see above), you can make IHT-free gifts of up to £3,000 each tax year, and gifts on marriage/civil partnership ranging from £1,000 to £5,000 (depending on your relationship to those who are marrying). If you miss making the gifts totalling £3,000 in one year, you can catch up in the next tax year by giving a total of £6,000, but you can only carry forward the £3,000 allowance for one tax year.

Invest in businesses to save IHT

The value of shares in unquoted trading companies, including companies listed on the AIM stock exchange, are free of IHT if you hold them for at least two years. You don't have to be involved in the company for the shares to qualify. The investment risk can be mitigated by investing in AIM portfolios, including AIM ISAs. Any interest you hold in an unincorporated business will generally also be free of IHT.

Value let property correctly on death

To assess the amount of IHT due after a death, the executors must value assets at their open market value on the date of death. However, if a property was let at that time, the value should take into account the sitting tenant and the time left until the tenancy or lease can be surrendered. The value of a property where there is a sitting tenant can be lower than if there is vacant possession.

We hope that these tips have been useful. If you have any queries, please get in touch.

Our next tax planning tips guide will cover **Your business – making the rules work for you**