McEwanWallace By your side

Managing inheritance tax

Like many other taxes, inheritance tax (or IHT) allowances have been frozen. This sounds generous of the chancellor at a time when the government is strapped for cash. But it actually means that we are paying more. Data from HMRC has revealed that Inheritance tax collected between April 2022 and February 2023 totalled £6.4bn, which is £900m higher than the same period last year.

The rise is actually due to the frozen tax-free allowance for inheritance tax (also known as the nil-rate band) – coupled with the rocketing rise of house prices.

It's estimated 10,000 more families could end up paying IHT, while the Treasury could receive nearly £8 billion a year over the next few years.

<u>How can you reduce your inheritance tax bill?</u>

When you die, your estate is valued, and this value is subject to inheritance tax (IHT). Generally, any excess over the nil-rate band (currently £325,000) is chargeable to inheritance tax at 40%. But there are ways to reduce your inheritance tax bill.

1. Give it away

The easiest way to pass your wealth onto your loved ones without paying tax is simply to give it to them.

- You can give up to £3,000 to loved ones each tax year without it becoming liable for IHT. If you didn't use the allowance last year, you can combine it and pass on £6,000
- Gifts of £5,000 to children for a wedding are also protected from IHT; grandchildren can have up to £2,500

If you die within seven years of making a larger gift, IHT will be payable. There's a sliding scale. Die three to four years after giving, the IHT rate lowers to 32%. At six to seven years it falls to 8%.

There is another way to give. Donate at least 10% of your estate to charity and get a 4% discount on your IHT rate for the rest of your estate, lowering it from 40% to 36%.

2. Put it in a pension

Your pension, depending on the type of pension plan you hold, if it is kept invested could be used to pass on wealth as it is usually excluded from your estate for IHT purposes. Nominate beneficiaries for your pension should you pass away before you receive it, and IHT isn't normally payable.

If you die after the age of 75 your beneficiaries will need to pay income tax on the money they take out.

3. Invest it (carefully)

Making the right kind of investments might help you avoid IHT. An individual savings account (ISA) can't help. ISAs are exempt from income tax and capital gains tax, but they form part of your estate for IHT.

There could be other solutions such as with Alternative Investment Market (AIM) holdings.

The companies listed on AIM tend to be smaller and more highly speculative in nature, in part due to AIM's relaxed regulations and listing requirements. However, Investing in AIM companies tends to be high risk investing and is not a route most people should consider. You should seek independent financial advice before considering investing in this market, remembering that, when investing, your capital is at risk and you could lose some or all of your investment.

4. Put it in trust

Setting up a trust to hold your assets could keep them out of your estate, and out of the taxman's reach – but the position has become more complicated in recent years, and it might not always be suitable. They may still have their uses. The trustee can control the assets, rather than them being passed onto the beneficiaries right away. This might help if your beneficiaries are not known for financial prudence or are young children. You should seek Independent financial/legal advice before establishing a trust.

5. Insure it

You can take out a whole of life insurance policy large enough to mitigate some or all of your IHT liability. You may need to regularly review the level of cover if your estate increases in value as the original sum assured may not cover the whole IHT liability. Alternatively, you may choose a plan where the cover increases with inflation. Whichever option is chosen, have it written in trust. Your beneficiaries won't struggle with a huge inheritance tax bill when you die, but while you are alive you will be paying monthly premiums.

6. Get some help

Expert advice can be vital to help work out the total value of an estate, calculate how much inheritance tax is likely to charged and understand what options are available to manage that tax bill. Advice on writing up a will to be tax efficient is also essential.

Please talk to us about any tax related questions you may have and if you need a financial adviser, we can help point you in the right direction.