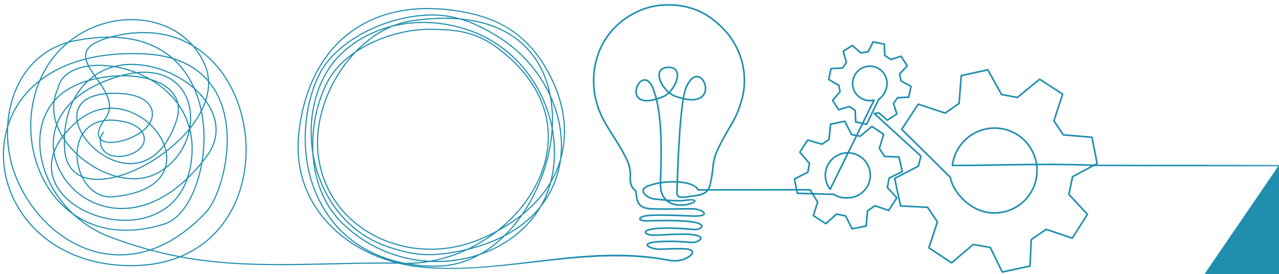
financial advice centre

Independent Financial Advisers

A Financial Advice Centre Ltd Inheritance Tax Guide

# A guide to untangling inheritance tax



## YOUR ADVISER

Piers Mepsted
07866 562 461
piers@face-uk.com

Financial Advice Centre Ltd is a multi-award-winning team of West Midlands-based Independent Financial Advisers (IFA's) and Wealth Managers. Founded in 1999, the team has grown to become a leading West Midlands based firm recognised for progressive thinking and a refreshing, transparent approach to managing and advising on client funds.

Our Advisers have deep technical expertise and offer an innovative approach to financial advice as seen through our proven pedigree of successful strategies in these areas:

- **Bespoke Investment Strategies**
- **Retirement Planning Solutions**
- **Pension Drawdown and Freedoms**
- **Wealth Management**
- **Inheritance Tax Planning**
- **Mortgages**
- **Life Assurance and Protection**

We are active Advisers with a unique charging structure focussed on building long-term relationships and consistently adding value to clients' investment propositions. Our aim is to provide a service that is both forward-thinking and independent to help clients achieve their financial objectives.

Clients choose to work with us because we simplify a complicated financial environment and consistently deliver results in a way that's easy to understand.

financial
advice centre
Independent Financial Advisers

# Find it fast

# Helping to untangle inheritance tax

Although often in the news, inheritance tax is still not widely understood. That's worrying, because it affects thousands of families every year.

If you thought inheritance tax was just for extremely wealthy people to worry about, think again. Recent reforms to inheritance tax and rising property prices, in recent years, have meant more estates than ever are likely to face an inheritance tax bill. In fact, the amount of inheritance tax collected is expected to reach £9 billion by 2027-28, an increase of £1.5 billion in just three years.[1]

**As pensions will be subject to inheritance tax from April 2027, this number is expected to be even higher.**

If your estate has an inheritance tax liability, your beneficiaries will have to pay the inheritance tax bill. This may not be the kind of legacy most people think of leaving behind.

The good news is that there are plenty of things you can do – in your lifetime – to take care of a potential inheritance tax problem. But finding the right options for you will depend on your personal circumstances. In this guide, we set out some of your options in more detail to help you make an informed choice.

Estate planning can be complicated. But it doesn't have to be. Talking to a financial adviser about your situation can make a real difference. At Financial Advice Centre Ltd, our experience is that too many people are leaving their loved ones with a large and unnecessary tax bill to pay.

We hope this guide can help you take the initiative.

**HM Revenue & Customs (HMRC) collected £7.5 billion from thousands of bereaved families in 2023-2024.[2]**

[1] Office for National Statistics and Office for Budget Responsibility, July 2024.

[2] HMRC Tax & National Insurance Contributions for the UK , HMRC, 19 July 2024.

# Inheritance tax: The basics

Inheritance tax is paid on the value of the assets that a person leaves behind when they die. It can also apply to some gifts that are made before someone dies.

## When you die, your 'estate' is the assets you leave behind

If you are married, or have a civil partner, then you can leave your entire estate to your spouse or partner free of inheritance tax. But if you want to leave some or all of your estate to family and friends, then it may be liable for inheritance tax.

## Not everyone is required to pay inheritance tax

But if the value of your estate is worth more than £325,000 (known as the 'nil-rate band'), then HMRC will expect you to pay inheritance tax at a rate of 40% on the total value of assets in your estate over that amount.

## Your estate can include:

- Your house and any other properties you own.
- Any savings or investments (ISAs, are taxable).
- Any other assets.
- The value of any life insurance policies in your name.
- From 6 April 2027 - Pensions.

## How to work out what your estate is worth

After adding up all your asets and certain gifts made in the seven years before death, your next step should be to subtract any outstanding debts. These could include credit cards, loans and mortgages. You can also deduct the value of some gifts you make during your lifetime (we explain the gifting rules on **page 17,** charity donations left in your will and the reasonable costs of your funeral over that amount.

* You can reduce the rate of inheritance tax payable from 40% to 36% if you leave at least 10% of the value of your estate to charity. Donations made to charity upon your death are not subject to inheritance tax.

## After calculating the potential value of your estate for inheritance tax purposes:

**Is the potential value of your estate less than £325,000?**

Your estate isn't facing an inheritance tax bill right now. However, it's worth keeping an eye on the value of your assets, as any changes between now and when you die could mean an inheritance tax bill for some of the assets you leave behind.

**Is the potential value of your estate more than £325,000?**

Then your nil-rate band will be fully used up, and the remainder of your estate will be subject to inheritance tax.

---

**Modern inheritance tax dates back to 1894, when the government introduced 'estate duty' as a tax on the capital value of land.**

## Here's an example of how inheritance tax is calculated for individuals:

**John Smith dies, leaving behind an estate of his home and investments**

£500,000

**Subtracting the nil-rate band (£500,000 - £325,000), his taxable estate is valued at**

£175,000

**The taxable estate will be liable for inheritance tax at 40%**

£70,000 — Inheritance tax bill (175,000 x 40%)

# How marital status affects inheritance tax

How the inheritance tax rules apply will differ depending on whether you are single, married or in a civil partnership.

## Single

If you're single and your estate is worth more than £325,000, anything over that amount will be liable for up to 40% inheritance tax.

## Married/Civil partnership

If you're married or in a civil partnership, the assets you leave to your spouse will be transferred without any inheritance tax to pay. Also, leaving assets to a spouse does not use up your nil-rate band.

If you pass on any of your estate to someone other than your spouse or civil partner, and your estate is valued at more than £325,000, then the excess will be subject to up to 40% inheritance tax.

The estate of your surviving spouse, now widowed, will be subject to inheritance tax as outlined **on page 9**.

**Beneficiary – the person (or people) who receives an inheritance when someone dies, or benefits from a trust.**

## Widowed

When someone dies, their unused nil-rate band can be transferred to their spouse or civil partner.

For example, if your spouse left everything to you before they died, you could potentially have a combined nil-rate band of £650,000 applied to the value of your estate. From 6 April 2026 everyone has a new Business Relief and Agricultural Property Relief (APR) £1 million allowance (we explain this further **on page 26).** This allowance is not transferable to your surviving spouse.

## Unmarried couple

If you are part of an unmarried couple, you are still treated as single for inheritance tax purposes.

This means that each of you has a separate nil-rate band of £325,000 which cannot be combined upon death.

## How inheritance tax is calculated after a spouse has passed away

**John Smith dies, leaving his entire estate to his wife Jane**

£500,000

**Jane now has combined assets (£500,000 + £450,000 of her own)**

£950,000

**Subtracting the combined nil-rate band (£950,000 - £650,000)**

£300,000 (Jane Smith's taxable estate)

**Jane Smith's estate would be taxed at 40%**

**£120,000** **Inheritance tax bill** £300,000 x 40%

# The residence nil-rate band

A new inheritance tax allowance was introduced in 2015. But the headlines that claimed it will give people a £1 million nil-rate band need closer scrutiny.

## Inheritance tax is a problem for homeowners

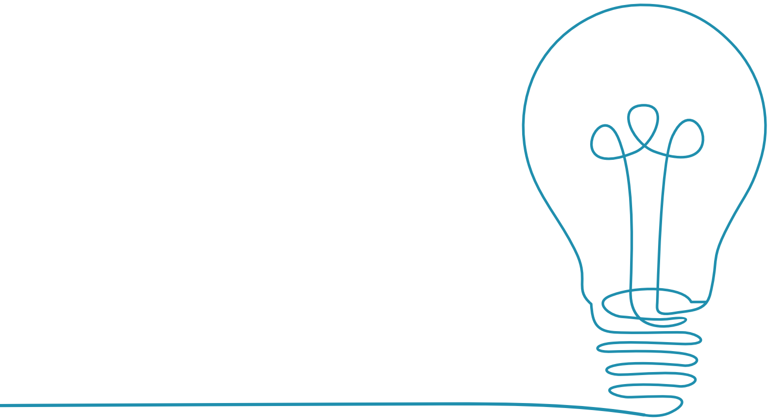
After years of rising house prices, more people are now facing an inheritance tax liability on their estate, thanks to the increase in the value of their home. What's more, the current nil-rate band of £325,000 for inheritance tax is going to remain frozen until at least 2030.

In 2015, acknowledging the inheritance tax problem faced by large numbers of homeowners, the Government introduced an additional inheritance tax allowance of up to £175,000 to apply to the family home in certain circumstances. This allowance is also frozen until at least 2030. However, forecasts show that HMRC's inheritance tax receipts are still expected to continue to rise.

## The residence nil-rate band

- The residence nil-rate band applies to the estates of people who die after 6 April 2017.
- You must plan on leaving a home to your children or grandchildren.
- The allowance was phased in and reached the maximum of £175,000 per person for deaths that occur after 6 April 2020 (£350,000 per couple).
- Adding this to a couple's nil-rate band equals £1 million per couple.
- The allowance is frozen at £175,000 until at least 2030.

**Despite the intentions of the residence nil-rate band, the number of people who will be able to leave an estate worth £1 million completely free of inheritance tax is likely to be limited.**



## Who can claim the allowance?

The intention is that married couples and civil partners can pass on assets worth £1 million (the combined nil rate band allowances), including the family home, without paying any inheritance tax at all.

However, not everyone will benefit, and there are a few rules to be aware of:

- As the name suggests, this allowance will apply where the person who has died owned a property that was at one time their home.
- It will also only apply if the property is being left to the deceased’s direct descendants (children or grandchildren).
- It won’t help you if you don’t own a property. Also, anyone without direct descendants, or who wishes to leave their home to someone other than a direct descendant, cannot benefit.
- Anyone without a property worth at least £175,000 per person, or £350,000 per couple, will only partially benefit.
- The residence nil-rate band will be reduced by a rate of £1 for every £2 by which the estate exceeds £2 million. This means that larger estates may not benefit.
- Anyone who disposed of their property before 8 July 2015 – for example, because they are in residential care or living with their children – will not benefit from the new allowance at all.

## What about spousal transfers?

The existing nil-rate band works so that if the first spouse or civil partner to pass away leaves their entire taxable estate to their surviving partner, then the estate of the second spouse can claim a total nil-rate band of £650,000 – double the individual nil-rate band.

In a similar way, the estate of the second spouse or civil partner to pass away will be entitled to claim double the residence nil-rate band applicable in the year of the second death, where their partner's estate did not make such a claim. The maximum amount of the claim will still be limited to (a) the greater of the allowance at the time of the second death, and (b) the value of the home owned by the deceased.

## Key points

The residence nil-rate band has been flagged as allowing couples to claim £1 million of inheritance tax exemption. However, to do this, the following criteria have to be met:

1. One spouse must pass away after 6 April 2020, when the £1 million maximum was reached.
2. The surviving partner must own a home worth more than £350,000 when they die.
3. They must leave that home to their children or grandchildren.
4. The total estate must be worth less than £2 million; likewise for their deceased spouse.

# Leaving pensions as part of your estate

Following the Autumn 2024 Budget, whether your pension is liable for inheritance tax depends on if death occurs before or after 6 April 2027.

## 1. Your type of pension

Broadly speaking, aside from the State Pension, there are two types of pensions:

### A 'Defined Benefit' pension

This means you'll receive a fixed percentage of your final salary, payable to you over the remainder of your lifetime. However, the benefit of that income belongs to you, and sometimes to your spouse if they survive you. It cannot be left to anyone else in its current form after you die.

### A 'Defined Contribution' pension

This means you've paid into your pension during your working years so that you have a pot of money accrued in your pension at retirement. You can choose to take up to 25% of this pot tax free and use the remainder to purchase an annuity. An annuity pays you an income for life, but – similar to a Defined Benefit pension – cannot usually be left to your beneficiaries after you die.

Since 2014, it has been more widely possible to 'draw down' on your lump-sum pension pot, and use it to provide you with an income instead of purchasing an annuity. This pot is likely to be able to be left to your beneficiaries if you haven't drawn it completely when you pass away.

From 6 April 2027, unused 'Defined Contribution' pensions are subject to inheritance tax. Note that spousal transfers of these pensions remain inheritance tax free.

**The current rules relating to pensions are complicated. If you're unsure of how they apply to you, please speak to an independent adviser, like us, to get advice specific to your situation before making any decisions.**

## 2. The age at which you die

Your undrawn pension pot is free from inheritance tax where you die before 6 April 2027. If you die after this date, your undrawn pension should be subject to inheritance tax. Additional taxes may be payable by your beneficiaries when they draw down from the fund:

### If you die before turning 75

Anyone who inherits your pension will not be required to pay income tax as they draw it down.

### If you die after turning 75

The amount of income tax to be paid will be determined by the income tax status of whoever inherits the pension. They will have to pay income tax at their standard rate whenever they draw amounts out (the rates of tax are 20%, 40% and 45%).

**You will be subject to income tax on pension income you receive in your lifetime, and if you haven't spent it, the amounts drawn down will form part of your taxable estate when you die.**

# Making gifts to reduce an estate's value

You can always simply 'gift' your assets away. However, there are some pitfalls to be wary of.

## Some gifts are always inheritance tax free

For a start, any gifts between spouses or civil partners are free from inheritance tax. HMRC also gives you an annual gifting allowance of £3,000 every year. This is called the 'annual exemption'. If you don't use your full £3,000 annual exemption in one year, you can 'carry over' the remainder and use it the following year. However, you can only use this carry-over for one year.

You can also make small gifts (up to £250) to as many different people as you like, but you cannot use your annual exemption and your small gift exemption on the same person in the same year.

Wedding gifts are also free from inheritance tax, provided you keep to certain limits. You can make a wedding gift of up to £5,000 for your child, up to £2,500 for your grandchild, up to £2,500 as a gift to your spouse or civil-partner-to-be or up to £1,000 to anyone else. Of course, gifts between spouses are 100% exempt from inheritance tax.

Inheritance tax will not be paid on gifts made to charities, national museums, universities, the National Trust, political parties and some other institutions such as housing associations.

**According to unbiased.co.uk, inheritance tax is the second-most resented tax among the British public, beaten only by council tax.**

## While other gifts may be subject to inheritance tax

These are usually called ‘potentially exempt transfers’. They typically become free from inheritance tax provided the person making the gift survives for seven years after the gift is made. If the person who made the gift dies within seven years, the value of the gift will be included in their estate. The person receiving the gift will have to pay any inheritance tax due.

It’s worth noting that the rate of inheritance tax due reduces if the person making the gift survives between three and seven years (known as ‘taper relief’). However, as the nil-rate band is applied against gifts made in the last seven years first, taper relief will only help where gifts worth more than £325,000 have been given away in the seven years before death.

## Taper relief

| Time between making gift and death | Rate of taper relief |
|---|---|
| 0-3 years | No taper relief |
| 3-4 years | 20% |
| 4-5 years | 40% |
| 5-6 years | 60% |
| 6-7 years | 80% |
| Over 7 years | No inheritance tax due |

## Keeping a record of gifts made during your lifetime

You’re not required to keep details of the gifts you make while you are alive, but it’s extremely helpful if you do.

After you pass away, the executors who deal with your estate will have to account for any gifts you made during the last seven years of your lifetime. Keeping records will make this process much quicker.

# Setting up a trust

## Trusts can be used to make sure that assets are given to beneficiaries in a timely and controlled manner, without incurring an inheritance tax bill.

People usually set up trusts as a way to make sure assets are kept in the family over generations. The biggest advantage of trusts is that they can be set up exactly to your own personal wishes.

There are several different types of trusts to meet different needs. For example:

- If you want to leave assets to children or grandchildren, but you don't want them to have access to the assets until they're a certain age.
- If you want to impose certain restrictions on how your estate is allocated to beneficiaries.
- If you want someone to receive an income from your assets during their life, but ultimately want the assets to be passed to someone else.

### Understanding the limitations of trusts

Trusts offer much greater control as to where your money will go, but they can be complicated to set up. Additionally, since 2006, inheritance tax charges have applied when certain trusts are set up, and when assets are transferred out of the trust to the trust beneficiaries. This can make settling a significant amount into trusts less attractive. Assets settled into some kinds of trusts that are set up during your lifetime also take seven years before becoming exempt from inheritance tax, similar to making a gift directly to a beneficiary. If you die before then, the amounts settled into trust will be included in your estate, and inheritance tax will be payable if the estate is valued at more than the nil-rate band.

**Laws relating to trusts date as far back as the twelfth century, from the time of the Crusades.**

# Taking out life insurance to pay inheritance tax

There are two types of policies that can help with inheritance tax: whole-of-life assurance and term insurance. Assurance is intended to cover you until you pass away, whereas insurance covers you for a set period of time.

## Whole-of-life policy

With this type of policy, you specify an amount to be paid out after you die. Your beneficiaries could then use this lump sum to pay any inheritance tax due to HMRC.

## Term policy

Another way to insure against an inheritance tax bill is to take out a 'level-term' or 'decreasing term' policy.

This will pay a lump sum in the event of your death during a specific time frame. This could be useful if you've given large sums of money away in recent years, but you are worried that you may not live the full seven years before these gifts fall outside of your estate. Your policy would then pay an amount that could be used to cover the inheritance tax due on the gifts. Insurance can be expensive, and it gets more expensive as you get older. It usually also involves taking a health assessment before cover can be granted, which can be off-putting for many people.

If you're considering taking out insurance to take care of an inheritance tax liability, it may be helpful to think of it as effectively paying the inheritance tax bill yourself, in the form of the insurance premiums.

Most life insurance policies will form part of your taxable estate when you die, but if the policy is 'written into trust', any payouts from the policy after your death will be outside of your estate for inheritance tax purposes. Because of the complexities, it's always worth speaking to us to get financial advice so we can research the market to find the most competitive options for your circumstances.

**Remember: Taking out insurance doesn't reduce the amount of inheritance tax due on an estate, it is simply another way to pay a potential inheritance tax bill.**

# Business Relief (BR) can be a valuable feature for inheritance tax planning

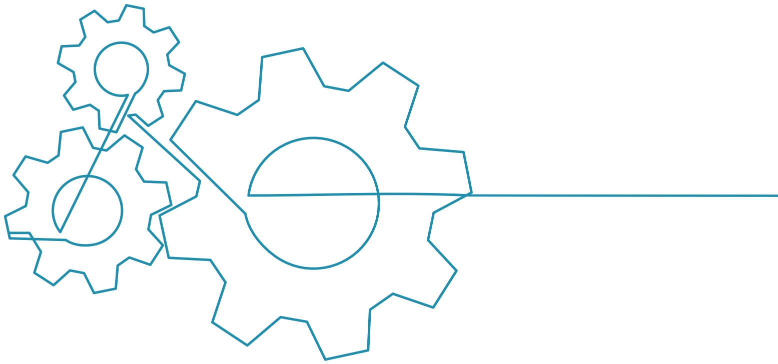
Investments in BR-qualifying companies are outside your taxable estate after 24 months. It allows certain investments to be left to your beneficiaries free from inheritance tax.

BR was introduced as part of the 1976 Finance Act, and it was created to allow small businesses to be passed down through generations without facing a large inheritance tax bill.

Over time, successive governments have recognised the value of a tax relief that encourages people to invest in trading businesses, regardless of whether they run the business themselves. But BR-qualifying investments are not intended just for tax planning purposes. Investors can consider BR as an incentive to invest in unlisted trading companies or those listed on the Alternative Investment Market (AIM). The tax incentives can compensate for some of the additional risks associated with investing in such companies.

## Why hold shares in BR-qualifying companies?

1. **Faster inheritance tax exemption:** Whereas making a gift or putting assets in trust means they take seven years before they become exempt from inheritance tax, shares in a BR-qualifying company or investment become zero rated for inheritance tax after being held for just two years, provided the shares are still held at the time of death.
2. **Greater access and control:** Unlike with a gift, the investor retains control over the investment and can sell the investment and get the proceeds back if they need to. However, shares sold or money taken out of the investment will no longer be exempt from inheritance tax.
3. **Simplicity:** Buying shares or an investment in BR-qualifying companies is relatively simple compared to setting up a trust or using life insurance, there is no requirement for underwriting or medial questionnaires.



## Investments that qualify for BR

We work with specialist companies that can set up portfolios featuring companies that qualify for BR for example - AIM-listed or unquoted companies. An investment like this will use the money it receives from investors to buy the shares of companies that it believes will qualify for BR. This means that as long as the investment has been held for at least two years, and is still held at the time of the investor's death, it can be passed on to the investors' beneficiaries free of inheritance tax.

Married couples and civil partners also have the benefit of a joint two-year qualifying period. This means that should the investor die within two years of investing, the investment can be transferred to their surviving spouse or civil partner without resetting the two-year clock.

## What are the risks?

**Capital is at risk**: The value of a BR-qualifying investment and any income from it, can fall as well as rise. You may not get back the full amount you invest.

**Tax rules and reliefs can change**: Your tax treatment depends on your personal circumstances and may change in the future. Also, whether the investment qualifies for BR will depend on the portfolio companies maintaining their qualifying status. HMRC will consider a claim for BR based on the facts when a claim is made, including the relevant legislation in place at the time.

**Shares could be more volatile and less liquid:** Investments in AIM-listed and unquoted companies are likely to fall or rise in value more than shares listed on the main market of the London Stock Exchange. They may also be harder to sell.

# An inheritance tax free ISA

## ISAs can offer valuable tax benefits during your lifetime, and with careful planning they can be removed from the IHT regime.

If you've been making full use of your annual allowances down the years, you could be sitting on a substantial portfolio of Individual Savings Accounts (ISAs).

But the fact that ISAs are subject to inheritance tax can be particularly damaging for anyone who has accumulated large ISA sums over the years.

**Neglecting to include your ISAs as part of your estate planning could prove a costly mistake.**

Someone who has built up an ISA portfolio worth £100,000, for example, could unwittingly land their family a £40,000 inheritance tax bill. But there is a way for you to gain exemption from inheritance tax without losing your lifetime ISA tax benefits.

### An ISA of BR-qualifying investments

Since 2013, it has been possible to invest in companies listed on AIM within an ISA. Provided that the companies qualify for BR, then the ISA can be passed on to beneficiaries after two years, just as with other BR-qualifying investments.

From 6 April 2026, AIM BR-qualifying ISAs will attract 50% inheritance tax relief. For deaths before this date 100% relief is available.

**To find out more please speak to us to find out the associated risks and benefits of this solution. Find us here www.face-uk.com/contact or email today - office@face-uk.com**

# Your inheritance tax checklist

## Work out how much you think your estate is worth:

| | |
|---|---|
| £ | **Property** |
| £ | **Savings** (including your ISAs) |
| £ | **Investments** (not including your pensions) |
| £ | **Other assets** |
| £ | **Life insurance** (not in trust) |
| £ | **Pensions after 6 April 2027** |
| £ | **Any likely inheritance from others** |

## Work out how much you owe:

| | |
|---|---|
| £ | **Mortgage** |
| £ | **Loans** |
| £ | **Credit card debts** |
| £ | **Overdraft** |
| £ | **Any other financial obligations** |

| | |
|---|---|
| £ | **Net worth** |

## If you think your estate could trigger an inheritance tax bill, you should consider talking to a financial adviser.

Take this checklist with you and have a think about the ways you might consider planning for inheritance tax:

- [ ] **Spend it, or give it away**
- [ ] **Insure it**
- [ ] **Put it into a trust**
- [ ] **Make inheritance tax free**
- [ ] **Investments**

Financial Advice Centre Ltd is registered in England & Wales no. 04425184. Registered Office at 7 Sansome Place, Worcester, Worcestershire. WR1 1UG.

Financial Advice Centre Ltd is authorised and regulated by the Financial Conduct Authority no. 413317. The information contained in this guide is subject to the UK Regulatory Regime and is therefore restricted to consumers based in the UK. It does not, and is not intended to, constitute legal advice; instead, all information, content, and materials discussed are for general informational purposes only. All liability with respect to actions taken or not taken based on the contents of this website are hereby expressly disclaimed.

Financial Advice Centre Ltd offers advice on investment portfolios that can benefit from relief from inheritance tax. It is not the intention of this guide to offer tax or investment advice, and we always recommend that investors seek professional advice with us or with a tax specialist to take account of personal circumstances before making any investment or estate planning decisions.

Financial Advice Centre Ltd offers advice on investment portfolios that can benefit from relief from inheritance tax. This guide does not intend to offer tax or investment advice, and we always recommend that investors seek professional advice with us or with a tax specialist to take account of personal circumstances before making any investment or estate planning decisions.

Investments that qualify for inheritance tax relief place your capital at risk, and the value of the investments can fall or rise. An investor may not get back the full amount invested. The tax benefit to each investor will depend on their personal circumstances and tax reliefs can change in the future. Investments in AIM-listed and unquoted companies that qualify for tax relief are likely to fall or rise in value more than shares listed on the main market of the London Stock Exchange. They may also be harder to sell.

The explanation of all of the tax rules set out in this guide were written in accordance with our understanding and interpretation of the law at the time of publication.

financial
advice centre

Independent Financial Advisers


**Worcester – Head Office**
7 Sansome Place
Worcester, WR1 1UG
T. 01905 731 864
**office@face-uk.com**