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What will your legacy look like?

Effective Inheritance Tax planning is a careful balancing act

Once a concern only for the very affluent, Inheritance Tax (IHT) is now an issue for many ordinary families, who may find themselves handing over an unprecedented portion of their estates to the taxman. This shift results from years of house price growth, inflation and stagnant tax thresholds. The Office for Budget Responsibility anticipates that IHT will bring in £7.2 billion in the fiscal year 2023/24[1].

Effective IHT planning is a careful balancing act. It's about ensuring you can live comfortably and meet your care needs while also considering how to pass on your wealth in the most tax-efficient way. Navigating these complexities can be challenging, but it's entirely manageable with open communication and careful planning.

Typically, IHT applies at a rate of 40% on the value of an estate above the 'nil rate' allowance of £325,000 (which has been frozen until April 2028). This figure escalates to £500,000 if a primary residence is bequeathed to a direct descendant. Assets passed to a spouse or registered civil partner are exempt from this tax.

Valuable reliefs and the seven-year rule

A variety of reliefs exist that enable families to protect more of their estate from IHT. The most significant of these is arguably the seven-year rule. This provision allows certain gifts to be tax-free, provided the giver survives for seven years after making the gift. However, this seemingly straightforward rule is fraught with potential pitfalls that could result in an unexpected bill from His Majesty's Revenue & Customs (HMRC).

Estate planning is a complex endeavour. Prudent giving requires sufficient funds to support a long life and cover care costs. Here, we explore the main tax traps that could cost you thousands and provide guidance on avoiding them.

Complications of gifting property

Often, the most valuable asset in an estate is the family home. However, the rules regarding property transfers are stringent. It is a widespread misunderstanding that transferring the legal ownership of a property to children while the parents continue to reside there will sidestep IHT. Such a transfer would be considered a 'gift with reservation' by the HMRC, as the original owner continues to benefit from the asset.

Avoiding the 'gift with reservation' pitfall

A parent wishing to transfer ownership but continue living in the family home would need to pay market rent to the new owner to avoid this situation. The HMRC would require a signed rental agreement specifying an annual rent review and evidence of payments.

Transferring ownership of your home while you continue to reside in it carries inherent risks, as you depend on the new owners not selling the property. Placing the property into a trust can help manage this risk, though this approach has its own costs and complexities.

Bestowing gifts and understanding the tax implications

Giving gifts can be a joyous act, but it's crucial to understand the context when it comes to IHT. If you pass away within seven years of giving a gift, IHT may be charged on the amount exceeding the £325,000 allowance. This is based on a sliding scale and if death occurs within three years, the usual 40% rate applies on amounts above this allowance.

For gifts that potentially violate the seven-year rule, if the gift exceeds the available Nil Rate Band Allowance, there would be tax on the recipient. If this isn't addressed, the deceased's estate typically handles the tax, which can become complicated with multiple beneficiaries.

Tax-free allowances and their exceptions

Certain allowances are exempt from the seven-year rule. You can give up to £3,000 each tax year without it being considered part of your estate later. However, this allowance hasn't changed for over four decades, and inflation has significantly diminished its value.

The annual allowance can be divided among several people or given to one individual, and unused allowance can be carried forward by one tax year. You can also give a tax-free gift £5,000 to a child or stepchild for their wedding or registered civil partnership. For a grandchild or great-grandchild, it's £2,500, and £1,000 for any other person.

Regular gifts from excess income

Regular gifts from your surplus income are exempt from tax, provided they don't impact your standard of living. These gifts must come from your regular income rather than the sale proceeds of a property. They might include payments into a child's savings account or to cover your child's rent. HMRC closely monitors this relief, so it's important to maintain detailed records of the amounts given.

Maximising your pension benefits

Pensions are one of the most tax-efficient benefits in life and after death. They usually don't form part of your estate for IHT purposes, though this doesn't apply to money already drawn from a retirement pot. However, there may be Income Tax to pay depending on when the donor dies and how the benefits are taken.

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If you die after age 75, your beneficiaries will pay Income Tax on money taken out of the pension at their usual rate. Beneficiaries can potentially reduce Income Tax on inherited pensions by withdrawing money gradually, and this also depends on their overall level of income

Role of trusts in planning

Trusts are versatile tools that play a significant role in estate planning. Individuals often opt to transfer gifts through trusts, which allows them to control the timing and purpose of the money's accessibility. This method ensures that the beneficiary can only access the funds under specific conditions, at a predetermined time, or at the trustee's discretion.

Moreover, life insurance policies can be integrated into an appropriate trust. This strategy ensures immediate access to funds for settling an IHT bill. Establishing a trust for your life insurance policy can provide a quick solution to potential IHT duties, preventing delays in the disbursement of the estate.

Power of Attorney is an essential tool in estate planning

Having a Power of Attorney in place is another crucial element of IHT planning and may require Court of Protection approval. It allows you to appoint someone you trust to make decisions on your behalf if you cannot do so. Knowing that your wishes will be respected even if you cannot express them personally can provide peace of mind.

Deprivation of assets and avoiding potential pitfalls

The term 'deprivation of assets' refers to deliberately disposing of property, assets or income to avoid care fees. If a local authority believes you've intentionally given away assets to evade these fees, they can charge you as if those assets were still part of your estate. Unlike the seven-year rule for gifts and IHT, there's no time limit here – a local authority can investigate the disposal of assets going back decades. ■

NEED HELP WITH INHERITANCE TAX PLANNING?

Inheritance Tax planning is complex, but with our advice, we could help you mitigate or reduce a potential tax bill with careful consideration and planning. You've worked hard to build up your wealth. So, it could be a good time to plan so your loved ones can get the most from the estate you intend to leave behind. For more information or guidance, please contact us.

Source data:
(1) https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/inheritance-tax/

THIS ARTICLE DOES NOT CONSTITUTE TAX OR LEGAL ADVICE AND SHOULD NOT BE RELIED UPON AS SUCH. TAX TREATMENT DEPENDS ON THE INDIVIDUAL CIRCUMSTANCES OF EACH CLIENT AND MAY BE SUBJECT TO CHANGE IN THE FUTURE. FOR GUIDANCE, SEEK PROFESSIONAL ADVICE.

THE FINANCIAL CONDUCT AUTHORITY DOESN'T REGULATE TRUST PLANNING AND MOST FORMS OF INHERITANCE TAX (IHT) PLANNING. SOME IHT PLANNING SOLUTIONS PUT YOUR MONEY AT RISK, AND YOU MAY GET BACK LESS THAN YOU INVESTED. IHT THRESHOLDS DEPEND ON INDIVIDUAL CIRCUMSTANCES AND THE LAW. TAX AND IHT RULES MAY CHANGE IN THE FUTURE.

Protecting yourself from investment scams

If something sounds too good to be true, it probably is

Investment scams are a rising concern, promising potential investors the allure of making a significant amount of money swiftly and effortlessly. These scams often involve minimal to no risk investments in various areas such as financial markets, property, cryptocurrencies, and precious metals and coins.

These schemes often masquerade as legitimate investments, with convincing websites, glowing testimonials and persuasive marketing material. However, it's crucial to remember that if something sounds too good to be true, it probably is.

One of the most notorious forms of investment fraud is the Ponzi Scheme. This method involves collecting money from new investors to pay off earlier ones. Eventually, the scheme crumbles when the debts exceed the incoming funds, leaving many investors penniless.

'Proven' investment strategies

Additionally, some scams start with offering complimentary investing seminars or training sessions. These free offerings usually serve as bait, leading to substantial charges for additional lessons or coaching that claim to enhance your chances of success.

The scammers may assert that their programme provides you with an easy-to-use system, complete with a team of experts who handle everything on your behalf. They may also give you the opportunity to learn about 'proven' investment strategies.

Evolution of scams in the digital age

In today's digital age, investment scams have evolved into intricate webs of deceit. Some are so convincingly crafted that even seasoned investors fall prey to them. Scammers employ various tactics, such as cloning legitimate firms' websites or luring potential victims into unregulated investments, promising returns far superior to savings accounts.

The introduction of pension freedoms in April 2015 has made individuals aged 55 and over particularly susceptible to these scams. These individuals can now access lump sum payments from their pension pots, making them attractive targets for scammers.

Identifying the red flags

All investment scams share one common trait – they promise high returns with minimal risk. If an opportunity appears too good to be true, it likely is.

Stay vigilant and be aware of the warning signs that may indicate a scam:

- Unsolicited contact via phone call, text, email or door-to-door visit.
- The firm refused to allow a callback.
- Pressure to make quick decisions.
- Only mobile numbers or PO box addresses are provided as contact details.
- Promises of high returns with low risk.

Safeguarding against scams

To avoid falling victim to a scam, adhere to the following precautions:

- Dismiss any unsolicited calls, emails, texts or visitors. Legitimate investment companies will not cold call you or contact you unexpectedly.
- Verify the legitimacy of a company by checking the FCA register or the FCA warning list.
- If considering an investment opportunity, seek professional financial advice from an FCA-regulated firm.
- Always pay full attention to fraud warnings when making a payment: they are there for your safety.

Marketing fake investment products

Fraudsters are going to great lengths to market fake investment products, often impersonating known brands and appearing perfectly professional. With the prospect of high returns and financial protection, many people are losing most of their savings to this scam. ■

NEED MORE INFORMATION?
Please contact us if you require further information or have questions about investment scams. Don't let scammers take advantage of your hard-earned money. Stay informed, stay safe.

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To arrange a complimentary consultation or review, please contact our Independent Financial Advisers on 01803 224888.

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