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CHARTERED ACCOUNTANTS

PayLessTax
2026 IHT Special

An Altruistic IHT Solution

More and more people are being brought into the inheritance tax (IHT) net for various reasons:

a) Freezing of reliefs/exemptions such as the nil rate band of £325,000 (April 2009), the residence nil rate band of £175,000 (April 2020) and the annual gift exemption of £3,000 (April 1981).

b) Property values outstripping the rate of inflation.

c) Business Property Relief (BPR) and Agricultural Property Relief (APR) being restricted to £2.5 million from April 2026 with 50% of the excess being taxed at 40%.

d) Pension values being brought into the IHT equations from April 2027.

One option which may be worthwhile exploring to potentially mitigate this problem is to bequeath 10% of your estate to charity. By doing so, the remainder of the estate, after taking account of exemptions/reliefs may be taxed at 36% as opposed to 40%.

Only 10% of one of 3 components which might make up your estate needs to be left to charity. Those components are:

- The general – assets held in your name only. For example a property held as tenants in common (pro-indiviso in Scotland).
- The survivorship – assets held in joint names. For example a joint bank account.
- The settled property – where you have a beneficial interest in an asset held within a trust.

The 10% is calculated on the baseline figure of that component after taking account of the nil rate band exemption and any eligible reliefs relevant to that asset such as the 100% BPR/APR. In this scenario you do not take into account the residence nil rate band. It can result in the non-charity beneficiaries ending up with more in their pocket whilst the charity has benefited too.

For example

- Ben Garrity has sadly passed away. His estate on death was worth £750,000.
- The assets were solely in his name and therefore fell within the general component only.
- His will left £50,000 to the National Trust.
- After taking account of the nil rate band of £325,000 and the gift itself, his baseline figure is £425,000. The charitable gift is more than 10% of that amount.
- The reduced IHT liability will be £135,000 compared to £150,000 at full rate. Leaving an additional £15,000 to be paid out to the non-charity beneficiaries.

If a person has died within the past 2 years and the charitable donations are below 10%, then it is possible, subject to it being of value to the non-charity beneficiaries, to enter into a deed of variation taking the gift over the threshold and applying the 36% IHT rate rather than the 40%.

TIP... It is worthwhile ascertaining your present IHT position as well as projecting forward to factor in the change coming into play from April 2027 respectively. If that is of interest to you please do not hesitate to contact us.

The Pension Hit

Depending upon who you listen to, bringing pension values into the inheritance tax (IHT) arena from April 2027 could result in a further estimated 10% -20% of estates being caught by the IHT net.

Those estates already over the IHT threshold may find estate liability increases because of this forthcoming legislative change. This, of course, has been exacerbated by the fact that the IHT reliefs have been frozen until April 2031. These being the nil rate band of £325,000 and the residence nil rate band of £175,000.

The positive news is that all death in service benefits and final salaried pension schemes will not be caught by the new IHT rules. **However, the vast majority of pensions, those falling under the money purchase arrangements, will be caught**.

Let's look at a couple of examples.

Jon Brady

Jon is divorced. He is leaving his entire estate to his daughter, Tania upon his death.

Jon's estate is made up of:

House £450,000; Investments £50,000; Pension pot £300,000.

If Jon died before 6th April 2027 the estate's IHT bill would be zero. Post 5th April 2027 his estate would need to pay across £120,000 in IHT.

John and Mary Rudge

John and Mary are married and have a son called Marcus. Their respective wills leave everything to the surviving spouse and then to Marcus on second death.

Their combined estate is made up of:

House £1.5 million; managed investment portfolio £500,000 and pension pot £700,000.

If the second death occurred pre 6th April 2027 the IHT liability would be £400,000. Post 5th April 2027 the IHT bill rises to £820,000.

This substantial increase arises primarily because the pension pot will be taxed at 40% but also because the combined residence nil rate band relief of £350,000 is lost because the second death estate is now worth £2.7 million. This results in a further £140,000 being added to the IHT bill.

TIP... We can carry out a IHT review for you and compare your present IHT position to that post April 2027 and then look at planning options off the back of that.

Gifts out of Income

With the freezing of various inheritance tax (IHT) reliefs until April 2031, controversial restrictions on business property relief and agricultural property relief since April 2026 and bringing the majority of pension pots into the IHT arena from April 2027, the Government is conservatively estimating the tax yield will double to just under £16 billion.

One option to mitigate this heightened tax risk is to gift an asset away. However, if this is done as a one off or on an irregular, ad hoc basis you would normally need to survive 7 years after the gift for it to fall outside your estate for IHT purposes.

However if you were to make regular, habitual gifts as part of your normal expenditure out of surplus income and it does not have a negative impact upon your usual standard of living, the value of it would immediately be exempt from IHT.

On paper this sounds an easy thing to achieve but in practice it may not be the case, especially for your poor old executor making the claim for the IHT relief upon your subsequent demise, unless you have banked the evidence to support it.

- **It would be wise to draw up a legal document detailing the intention to make regular gifts out of income**. Stipulating how often this would take place. The terms of this should be religiously adhered to.

- **Jewellery or other capital assets will not, in general, qualify for this relief. It should be cash**.

- **You cannot draw down on your capital reserves in order to maintain your standard of living to replace the income gift you have made.** Income from earlier years can come into the equation. However HMRC take the view that income becomes capital after a period of two years.

- **The Executor will need to complete a form IHT 403 in order to make the IHT claim**. On the final page of that form they will need to break down for the year of death and each of the previous 7 years, details of your different sources of income, the tax suffered, along with the expenditure you incurred broken down into categories in order for them to demonstrate the surplus income available for a regular gift to be made. **It would be strongly advisable to cast an eye over that form in advance of starting this process and keep records in line with it from the very beginning**.

TIP... If you want your estate to benefit from this IHT relief and need assistance in setting this process up please do hesitate to contact us.

Trusts – Inheritance Tax

People turn to Trusts for many different reasons be that:

- Safeguarding family assets (e.g. cash, property or shares) for future generations.

- Keeping control of how, when and to whom those assets and the income derived from them are distributed.

- Preventing the assets ending up with unintended people. This might be, for example, ensuring the children from a first marriage are protected following a second marriage or putting a protective wrapper around the asset in case a beneficiary suffers a divorce.

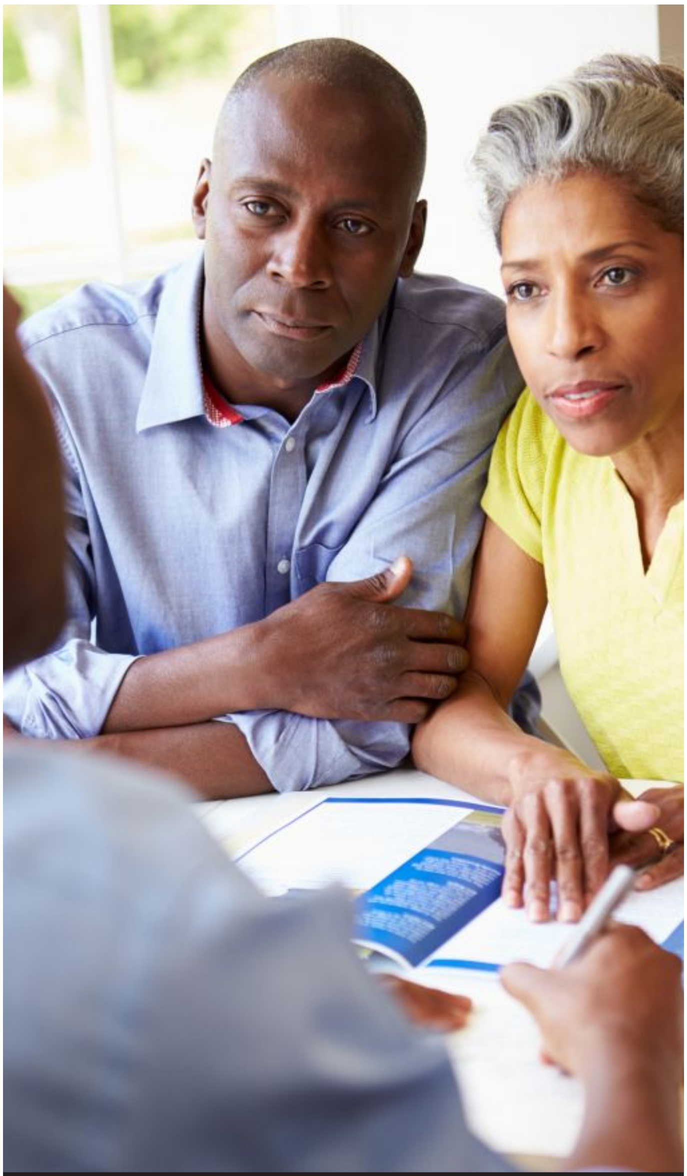
- Potentially avoiding a capital gains tax charge when gifting the asset into the Trust.

- **To mitigate their inheritance tax position**.

In this latter case if you settle assets within a Trust any growth in value from that day forward falls outside your estate for inheritance tax (IHT) purposes. The value at the time of going into the Trust will also achieve the same ends if you survive 7 years from the date of settlement.

Assuming you have not already done something similar in the previous 7 years, if you gift assets into certain types of Trusts such as a discretionary or interest in possession Trusts, there could be an immediate lifetime IHT charge of 20% of the asset value which exceeds £325,000 at the time it is settled in it. If it is a business asset such as your company shares or farmland for example, the IHT charge remains at 20% but only in respect of 50% of the value in excess of £2,825,000. The IHT suffered at this point may be credited against your overall IHT liability upon death if that occurs within 7 years of gift into the Trust.

Every 10th anniversary of the Trust the assets within it are revalued. In simple terms, if it is a non-business asset, the value in excess of £325,000 may be taxed as high as 6%. If it is a business asset and the value exceeds £2,825,000, only 50% of the excess may be taxed up to 6%. These calculations can be distorted if you have set up more than one Trust either on the same day as this one or in the previous 7 years. If the Trust distributes the assets out to the beneficiaries within the 10 year timeframe then the 6%/3% tax charge is prorated to cover the period it remained within the settlement.



TIP... Whether the Trust route is right for you is dependent upon many circumstances. We would be delighted to sit down with you to discuss whether or not the Trust option is the right fit for you and your family.

We are here to help

We can help you by ensuring that you're aware of the changes that will affect you, your family and your business. To find out more about the ways that we can help you, do not hesitate to contact us.

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