

# Tax Efficient Inter-Generational Wealth Transfer



Mishcon de Reya

It's business. But it's personal.

# Tax Efficient Inter-Generational Wealth Transfer

- ❖ Tax can prove to be a significant obstacle to the passing of wealth to others.
- ❖ IHT as a “voluntary tax”.
- ❖ Minimise with careful planning during lifetime

# IHT – an introduction

Inheritance Tax or “IHT” is charged at the following rates:

- ❖ “nil rate band” of £325,000 charged at 0%
- ❖ 20% for chargeable lifetime gifts; and
- ❖ 40% on estates on death
  
- ❖ The nil rate band can be used up in lifetime by:
  - Chargeable lifetime gifts
  - Or what are referred to as Potential Exempt Transfers made within the seven years before death

There are several IHT exemptions and reliefs available which can be used to pass wealth down to the next generation during your lifetime, reducing the size of your taxable estate on your death.

# Lifetime IHT Planning Exemptions

## Use the Nil Rate Band

The nil rate band “refreshes” every 7 years so if you were to give away £325,000 today, wait 7 years and you could then give away another £325,000 and so on. Couples can give away £650,000.

## Spouse Exemption

The most important IHT exemption is “spouse exemption”. IHT is not payable on any gift made between spouses during lifetime or on death.

# Lifetime IHT Planning Exemptions

## Gifts of any size

You may make outright gifts of any size to anyone and these will generally be exempt from inheritance tax, provided you survive the gift by seven years or more – known as potentially exempt transfers or “PETS”

- ❖ Survive 3 years+ and amount of IHT starts to taper.

## Regular gifts out of income

Regular gifts are exempt from inheritance tax if made as part of your normal expenditure out of income.

- ❖ Must keep detailed records so as to be able to evidence standard of living unaffected
- ❖ A pattern of giving is required, for example paying grandchild’s school fees

# Lifetime IHT Planning Exemptions

## **Small Gifts**

Gifts to any individual up to £250 per tax year – cannot be carried forward

## **Gifts on Marriage**

Each parent can give £5,000

Each grandparent can give £2,500

## **Annual Exemption**

£3,000 per tax year; any unused part of this exemption for a particular tax year can be carried forward for one tax year only

# Lifetime IHT Planning Reliefs

## Business property relief

- ❖ If you own a business or shares in a private trading company, the business or the shares may qualify for 100% business property relief (BPR), meaning that they are totally exempt from IHT.
- ❖ Shares in most companies quoted on AIM qualify for BPR.
- ❖ Minimum ownership period of 2 years
- ❖ Consider deliberately investing in assets that qualify for BPR

# Lifetime IHT Planning Reliefs

## Gifts to charity

- ❖ not strictly a way to pass wealth to the next generation
- ❖ If you give money to charity, whether during your lifetime or in your Will, the gift will be exempt from IHT.
- ❖ A legacy to charity in your Will of at least 10% of your taxable estate will result in a reduction in the rate of IHT payable on the rest of your estate from 40% to 36%. **BUT** the beneficiaries of your Will receive less.

# Lifetime IHT Planning Reliefs

## Effect of 10% to charity on £1m estate

	No gift to charity	7% (£70k) to charity	10% gift to charity
Amount passing to charity	£0	£70,000	£100,000
Amount passing to children	£600,000	£558,000	£576,000
IHT	£400,000	£372,000	£324,000
Total	<u>£1,000,000</u>	<u>£1,000,000</u>	<u>£1,000,000</u>

# Lifetime IHT Planning Anti-Avoidance Measures

## **Gifts with Reservation of Benefit**

- ❖ “GROBs” - any gift must be outright with no strings attached
- ❖ You can't give away your home and continue to live there

## **Pre-Owned Assets**

- ❖ You cannot give away something (land, chattels, investments) and subsequently benefit from it
- ❖ If the rules apply an annual income tax charge arises

# Lifetime IHT Planning

## Trusts set-up during lifetime

### **Nil Rate Band Trusts**

- ❖ A married couple can create a trust holding £650k every 7 years

### **Trusts for Business Assets**

- ❖ BPR assets can be put into a discretionary trust free of IHT irrespective of their value.
- ❖ There would be no upper limit on how much can be transferred without the initial 20% IHT charge
- ❖ Capital gains tax (CGT) would need to be considered but gifts of shares in a private trading company should qualify for holdover relief.

# IHT Planning on Death via Tax-Efficient Wills

If lifetime tax planning is not possible, you can still achieve significant IHT savings for your beneficiaries by having a tax-efficient Will.

Consider placing your estate into a trust created by your Will instead of passing to your spouse outright

- ❖ Flexibility
- ❖ Tax advantages

What would such a Will trust look like? What would it involve?

# IHT Planning on Death via Tax-Efficient Wills

**In outline, your Will would:**

- ❖ leave your estate on trust for your spouse
- ❖ the trust would provide income for him/her (and potentially also capital if the trustees choose to pay it to your spouse) for the rest of their life.
- ❖ The trust would be very flexible; others could potentially benefit including your children and grandchildren and their spouses and civil partners.
- ❖ a letter of wishes would inform the Trustees how you would like them to deal with your estate after your death.
- ❖ The letter of wishes could, for example, ask your trustees to make gifts from the trust to people other than your spouse provided he/she is otherwise well provided for.
- ❖ The letter of wishes can be changed whenever you wish without needing to prepare a new Will.

# IHT Planning on Death via Tax-Efficient Wills – cont'd

## Reasons for using a trust

- ❖ Protecting your children
- ❖ Tax efficiency and onward gifts – Gifts from the trust during your spouse's lifetime
- ❖ Protecting your assets
- ❖ Making life easier for your spouse
- ❖ Practical financial help on your spouse's death

# IHT Planning on Death via Tax-Efficient Wills – cont'd

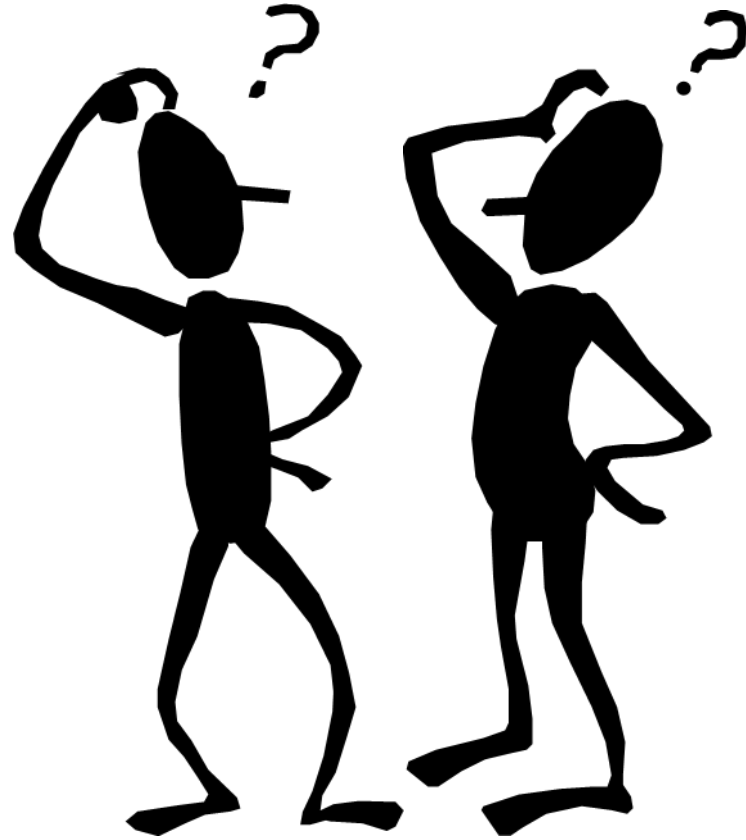
## Reasons for not using a trust

- ❖ Complexity

# Conclusions

- ❖ It is possible to minimise your estate's exposure to IHT via careful planning
- ❖ Use your available exemptions and reliefs to reduce IHT where you can
- ❖ Be mindful of anti-avoidance rules
- ❖ If lifetime planning is not possible ensure your Will is drafted in a tax efficient way so as to reduce the IHT payable on your death

# Questions?



# Contact

**Sarah Albury**

Senior Associate

E: [sarah.albury@mishcon.com](mailto:sarah.albury@mishcon.com)

T: +44 203 321 7042



**Disclaimer:**

This is a very basic summary of a complex area of law and taxation. It is not to be taken as legal advice. Before acting or omitting to act in relation to your UK tax position, you should always take specialist tax advice.

© Mishcon de Reya LLP 2022