



# The Origen Guide to Inheritance Tax Planning



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## Welcome

You've worked hard for your wealth. It's understandable to want to give as much as you can to loved ones so that, when you're no longer around, they are financially safe and secure.

If you have cash savings, investments, property and other assets, it's important to understand Inheritance Tax (IHT). This is a frequently misunderstood tax – many people assume it only applies to the super-wealthy – so it's increasingly catching many individuals and families out who don't realise that it can have a major impact on the amount they inherit.

Origen's national private client advice team are experts in IHT planning, investment advice and pension planning. Our financial advisers work closely with individuals, families and family businesses to protect and grow their wealth so that they can pass it on to future generations as tax efficiently as possible.

There's a lot to think about, and you're likely to have many questions. Our financial advisers are here to support, guide and advise you, so call us today and we'll help you to get started.



## What is Inheritance Tax?

Inheritance Tax (IHT) is a tax on the estate of someone who has died, including all property, possessions and money.

The standard IHT rate is 40%. It's only charged on the part of your estate that's above the tax-free threshold which is currently £325,000.

If the value of your estate that's left after deductions are made (such as loans, mortgages, credit cards and other debts) is less than £325,000 your estate won't have to pay any IHT. This is known as the nil rate band. However, if your estate is valued over £325,000, the executors of your estate will potentially need to pay IHT on everything over the nil rate band at a rate of 40%.

If you're a homeowner and you leave your home to a direct descendant, you can also make the most of an allowance called the residence nil rate band, which is £175,000. This, combined with your nil rate band of £325,000 means that your estate has a £500,000 allowance before it is liable for any IHT. Married couples, and those in civil partnerships, particularly benefit from these allowances; you can find out why on the opposite page.

It's important to note that IHT must be paid within six months of a death being recorded. There are various other aspects you will need to know that affect the allowances your estate can take advantage of, particularly if your estate exceeds £2 million. Your Origen adviser can guide you on what applies to you and your situation.

## Your relationship status counts

Whether you're single, part of an unmarried couple, married or in a civil partnership, your relationship status plays a big part in the IHT that your estate will need to pay.

### Are you single or part of an unmarried couple?

Your estate will pay IHT at 40% on anything over your nil rate band and residence nil rate band allowances. HM Revenue and Customs treats unmarried couples in the same way as single people, so you can't combine or carry over your allowances when one of the couple dies.

### Are you married or in a civil partnership?

If you leave your estate to your spouse or civil partner it will be free from IHT. When your spouse or civil partner dies, their nil rate band (and residence nil rate band, if their home is left to direct descendants) can be combined with yours and applied to the value of their estate. That means that there will at least be an allowance of £650,000, and potentially £1 million before any IHT needs to be paid.

### Quick glossary

**Estate:** In general terms this is the total of everything you own when you die, minus any debts.



# Inheritance Tax in action

Here are some examples of how IHT is calculated in different scenarios.



## How it works

### Scenario 1 - leaving an estate to siblings

On his death, John leaves an estate valued at £725,000 in equal shares to his surviving brother and sister. The estate includes John's home and other cash and investments. While the nil rate band of £325,000 is available, the residence nil rate band of £175,000 cannot be claimed as the house is not being left to direct descendants. John's estate will therefore pay IHT on £400,000 at 40%, so £160,000 in tax will be due.

### Scenario 2 - leaving an estate to children

Anya passed away two years after her husband Sam, with an estate valued at £900,000, including her home, worth £800,000. In line with her Will, her estate is to pass in equal shares to her four children. In addition to her nil rate band of £325,000, her estate can also claim the residence nil rate band of £175,000, as the home is passing to Anya's direct descendants.

When Sam died, all of his estate passed to Anya and therefore his nil rate band and residence nil rate band went unused. Anya's estate can therefore claim Sam's nil rate band and residence nil rate band alongside hers. This gives a total tax free allowance of £1 million. No IHT is therefore payable.



## Calculate your own estate value and IHT liability

Your Origen financial adviser can help you to complete the calculations below.

Assets: what do you have?	Value (£)
Home and other properties	
Savings including ISAs	
Investments (not your pension)	
Other assets	
Life assurance policies	
Gifts made in the last 7 years (in excess of the annual exemption of £3,000)	
<b>Total</b>	

Liabilities: what do you owe?	Value (£)
Outstanding mortgage/s	
Loans	
Credit card debt	
Overdraft	
Other financial obligations	
<b>Total</b>	

Calculate your IHT liability	Value (£)
<b>Value of your final estate</b> (assets minus liabilities)	
<b>Minus the nil rate band/s</b> (up to £325,000 for each person, so if your spouse or civil partner has died, you have their allowance too)	
<b>Minus the residence nil rate band*</b> (up to £175,000 for each person if you're leaving your home to direct descendants)	
<b>Amount of estate exposed to IHT**</b> (estate minus the available allowances)	

\*The residence nil rate band starts being withdrawn if your estate is worth more than £2m.

\*\*Certain assets are exempt from IHT – for example, business assets owned for more than two years.



# Gifts

There are many ways you can reduce your IHT liability, enabling you to pass on more of your wealth to the next generation. Giving money to loved ones during your lifetime is one way to reduce the value of your estate. However, there are rules around gifting that it's important to know, particularly as some gifts may be liable for IHT after you've died.

These 'lifetime gifts' fall into one of three categories: exempt gifts, potentially exempt transfers and chargeable lifetime transfers.

## Quick glossary

**Lifetime gifts:** A lifetime gift is money or other assets that that you give, without strings, during your lifetime.

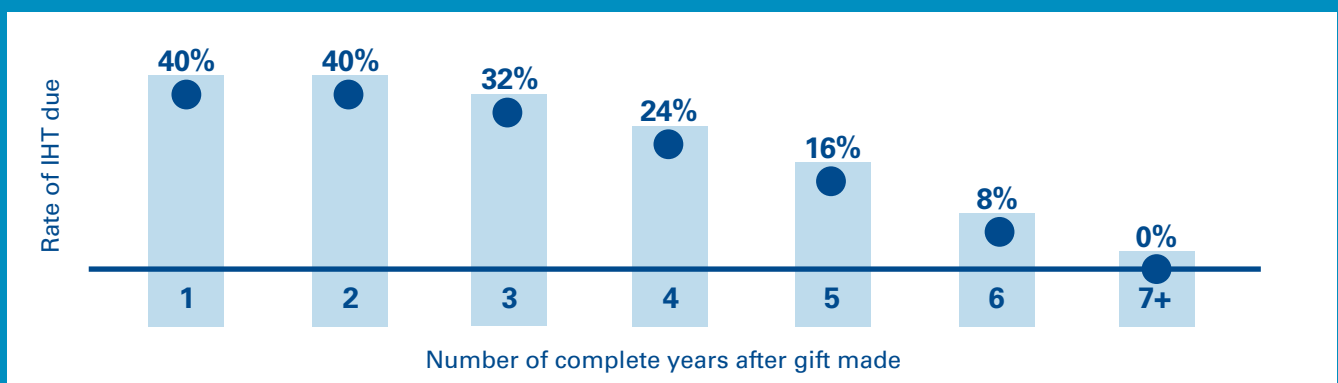
## Gifts that are exempt from IHT

No IHT will need to be paid on the following gifts:

- Up to £3,000 per tax year for any gifts.
- Small gifts up to £250 per tax year per recipient.
- Wedding gifts, up to £5,000 from parents, up to £2,500 from grandparents/great-grandparents and up to £1,000 from anyone else.
- Gifting from disposable income is disregarded for Inheritance Tax purposes. These gifts should form a regular pattern while not having an impact on your usual standard of living.
- Gifts and maintenance payments to support a family.
- Gifts to a qualifying charity in the EU, to a political party and to some national institutions e.g. the National Trust.
- Any gifts made between spouses/civil partners are entirely IHT free.

## Potentially Exempt Transfers

Gifts larger than £3,000 risk incurring an IHT bill and are called potentially exempt transfers (PETs). A PET can become free from IHT provided that you live for at least seven years after making the gift. The IHT due reduces on a sliding scale for each full year you live. This is known as taper relief. If tax is due on a PET, the person who received the PET will be asked to pay the tax.



## Chargeable Lifetime Transfers

A chargeable lifetime transfer (CLT) is when a gift is made which is immediately chargeable to IHT. This does not necessarily mean that an IHT charge will arise however it will have to be assessed for IHT purposes. These mainly relate to lifetime transfers to discretionary trusts (see page 14).

Provided the total amount of CLTs in any seven-year period does not exceed the nil rate band of £325,000, no IHT will be immediately payable on the transfer. If the total amount of CLTs in any seven year period exceeds the nil rate band, a tax charge will result at the lifetime rate of 20% on the amount over the nil rate band. If you die within seven years, a further 20% will become payable, although taper relief may reduce the actual tax due.



### How it works

James made a gift of £500,000 into a discretionary trust. This is £175,000 over his nil rate band of £325,000, meaning an immediate IHT bill of 20% on the excess (£35,000).

## Gifts with reservation

Gifts must be outright. If you retain an ongoing benefit from the asset you gift – perhaps you give away your home to your children but continue living there – it's likely to fall foul of the rules around 'gifts with reservation' and the value of the asset will remain in your estate until you stop benefiting from the gift.

### Questions to discuss with your Origen adviser

Do I have any unused allowances from the last tax year that I could use?

Can I make a tax efficient gift and help with ISA savings or pension contributions for my loved ones?

# Trusts

You can also reduce the IHT liability on your estate by gifting assets into a trust. This option is often used by families, particularly where considerable wealth is concerned or relationships are complex (for example, after divorce, or where step-families are involved).

A trust sits outside your estate, however a transfer into a trust may still be liable to IHT either as a potentially exempt transfer or a chargeable lifetime transfer.

When setting up a trust it's important to consider:

- ❓ The type of trust you want – who will benefit from the trust and when?
- ❓ The access you want/need to have to the trust funds.

## Why use a trust for estate planning?

- ✔ You want to leave assets to children/grandchildren but don't want them to have immediate access
- ✔ You want to gift money to your children/grandchildren, but want to receive an income while you are still alive
- ✔ You want a person to receive an income from your assets during their lifetime, but the assets are to be passed to other beneficiaries eventually.

## Quick glossary

**Asset:** Money, property and other possessions you own that have a financial value.

**Beneficiaries:** The people you choose to leave your estate to in your Will.



## Types of Trust

New trusts that Origen recommends generally fall into two different types – absolute trusts and discretionary trusts.

### Absolute trust

The beneficiaries for this type of trust must be selected when the trust is created and cannot be changed. Beneficiaries can demand the money once they reach age 18. Gifts to an absolute trust are subject to potentially exempt transfer rules.

### Discretionary trust

With a discretionary trust you don't have to select specific beneficiaries at the outset, so beneficiaries can be chosen by the trustees at a later date. This type of trust can be particularly useful when planning for future children and grandchildren. Gifts to a discretionary trust are subject to chargeable lifetime transfer rules.

Three of the most common trusts Origen recommends are gift, discounted gift and loan trusts. All of these can be set up as absolute or discretionary trusts.



### Gift trust

You make an outright gift of assets into the trust. Once the gift is made, you will have no future access to the capital or income in the trust. The value of the gift is outside your estate after seven years.



### Discounted gift trust

You gift money into a trust where you will lose access to the capital entirely, however you will retain the right to fixed annual withdrawals. The entire value of the gift is outside your estate after seven years.



### Loan trust

This allows you to lend money to the trust, so you retain access to the capital. The outstanding loan will remain within your estate and you can access the capital by way of regular or ad hoc repayments of the loan. Any growth on the investments will be outside of your estate.

Questions to discuss with your Origen adviser

Can assets be transferred to my spouse/civil partner or into a trust to help protect my estate from IHT?

## Would a tailored option suit you better?

It's possible to blend any of these trust options to accommodate your personal circumstances or to have a bespoke trust created by a legal professional. Your Origen adviser can advise on the best course of action based on your situation.



## Family investment companies

A family investment company (FIC) is a private company whose shareholders are members of the same family. This option offers a range of benefits of passing money on to future generations and is a very effective means of protecting family wealth in the event of a divorce or against creditors.

FICs work best for those with a substantial amount to invest (£2 million or more) and are willing to keep it in the family investment company to grow.

The parents will normally hold exclusive or majority voting control within the company, but have limited or no rights to income or capital. The junior family members can hold a separate class of shares benefiting from the majority, if not all, of the rights to capital and income.





## What are the benefits of a family investment company?

- ✓ FIC pays Corporation Tax at 25% on profits. This is compared to personal and trust Income Tax rates of up to 45%.
- ✓ Transfer of cash into the FIC is tax free and the amount is unlimited. You can also transfer property however this can become more complicated and further taxes may arise (CGT and Stamp Duty).
- ✓ Shareholders only pay tax when the FIC distributes income. An alternative way to drawing funds is via repayment of a directors loan.
- ✓ Investment managers and portfolio fees are tax deductible.
- ✓ The directors have the power to decide the level and timing of dividends.
- ✓ The FIC can be structured as an unlimited company – no need to file publicly available annual accounts.
- ✓ Any potential investment growth is held outside of your estate from day one.
- ✓ With special planning, your initial capital (gift/loan) can fall outside your estate after seven years.

## Questions to discuss with your Origen adviser

Would a FIC suit my family's profile?

What would be the income requirements for the founding shareholders?

How much would I gift outright?

What would be my investment strategy that would benefit all generations?



### How it works

Mandeep sold her recruitment business and after paying all taxes was left with £3 million. She knew that she wanted the money to go to her children and future grandchildren, but didn't want to lose control of the money.

Mandeep set up a FIC with a loan of £3 million. Her share class had the majority of the voting rights, retaining control of the company, with separate share classes for her children and future grandchildren. Mandeep drew annual loan repayments, and in future can decide to pay dividends or gift part of the loan to her children.

# IHT planning for business owners

If you own a business or businesses there are other important points to note in relation to IHT planning.

## Limited company investments

While the performance of corporate investments is not guaranteed, holding cash over the longer term has its own risks. If you own a business, it's important to review the cash that's held within company accounts.

Inflation can have a negative impact on the buying power of cash just like it does with personal assets. If the inflation rate exceeds the level of interest earned, then the real return to an investor will be negative. Over the longer-term, this can have a larger impact on the real return and future buying power of cash investments.

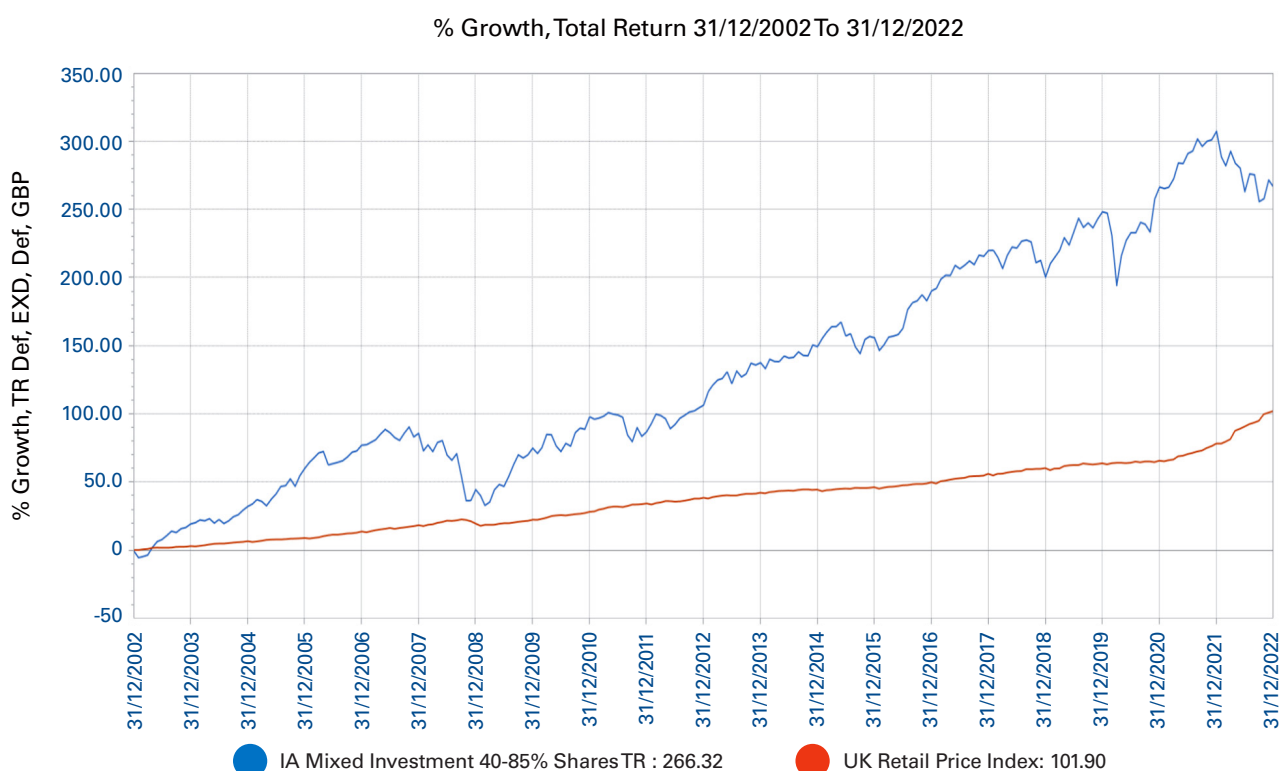
For example, if £1,000 was invested in a savings account paying 1% interest, after a year there would be £1,010 in the account. However, if inflation was 2% during the time, in order to maintain the same buying power after a year, £1,020 would need to be in the account.

Over longer periods, the impact of savings rates that remain below inflation can be significant.

While investing the capital incurs a greater risk, investment in funds, shares, bonds and other assets can offer greater potential to increase the value in real terms over the medium to longer-term.

## A snapshot of performance

Below is a typical investment portfolio performance over a 20 year period. Your Origen adviser will work closely with your accountant to maintain and enhance your tax reliefs while growing your assets over time.



## Corporation Tax

Companies are subject to Corporation Tax (excluding dividends) on the income and gains they receive from the investments they make. This includes cash deposit interest held within your company accounts.

You also need to be aware of how cash savings can impact business relief. We've already looked at how, if you own shares within a trading business, this will normally qualify for business relief after two years of ownership. Business relief allows a business to be passed on to future generations free of IHT.

However, cash built up within the company accounts or investments held could be regarded as an 'excepted asset' and not qualify for business relief, so there's a risk if the company holds excessive levels of cash or investments. In this case, business relief would be lost as HMRC could view your company as an investment company.

## Capital Gains Tax

As a shareholder looking to sell your business you may benefit from business asset disposal relief. This is taxed at a special rate of Capital Gains Tax of 10% up to a lifetime limit of £1 million. Like business relief, this is restricted to trading businesses and not investment companies. Holding excessive cash on deposit and other investments could have an impact on a company losing its trading status and business asset disposal relief. Your accountant can advise you on the best course of action, including potentially setting up a sister company to hold the cash.

HMRC has a 20% test in place to determine the structure of the trading company. This is based on several factors including turnover, assets, profits and expenses. Other considerations are time spent managing investments and income received from non-trading activities such as interest and investments.



## Onshore investment bonds

Any company-owned investment bonds your business owns will be assessed for Corporation Tax under the loan relationship rules and will be given a 20% Corporation Tax credit. This will have already been paid by the fund manager managing the investment fund. The tax is assessed when the underlying assets are sold.

## Unit trusts/Open-ended Investment Companies

These are generally more efficient for tax purposes as companies can target high yield, or dividend, stocks. Discretionary fund management may be to your advantage here as a fund manager can build a bespoke portfolio that meets your needs.

Tax is paid annually based on the value at the end of your accounting period. Any gains other than dividends are subject to Corporation Tax.

## Did you know?

The accounting basis that your company uses will determine how its investments will be taxed. There are two: historic cost and fair value. If you're unsure on the accounting basis your company operates, your accountant will be able to help.

# Other ways to reduce your IHT bill

## Reliefs

You may be able to take advantage of some IHT reliefs, enabling you to pass on some assets free of IHT or at a reduced rate.

### **Business relief**

Business relief (BR) provides relief from IHT on the transfer of relevant business assets at a rate of 50% or 100%. You don't even have to be a business owner to invest in BR-qualifying companies. What's more, once BR-qualifying shares have been held for two years they can be passed to beneficiaries free from IHT when the shareholder dies.

### **What are the benefits of investing in BR-qualifying companies?**

- It takes only two years before the shares become 100% free from IHT, rather than the seven years with gifting money or setting up a trust.
- Owning shares in a BR-qualifying company is relatively straightforward

### **Which companies qualify for business relief?**

A company needs to be a trading business and not deal in stocks, shares, land or buildings. It must not be listed on the London Stock Exchange (LSE), but could be listed on the Alternative Investment Market which is a submarket of the LSE for smaller companies.

### **Agricultural relief**

Subject to complex rules, the value of such property for IHT purposes may be reduced by 50% or 100%, depending upon the nature of the property transferred.

### **Charitable donation relief**

An estate can pay IHT at a reduced rate of 36% on some assets (instead of 40%) if 10% or more of the 'net value' of the estate is left to a qualifying charity.

## Pension contributions

Pension contributions provide a tax efficient way for both employers and employees to provide for retirement and potentially reduce any IHT bill.

Employer pension contributions generally qualify as a business expense and therefore are deductible from profits before assessment for Corporation Tax. In addition, they are free from employer National Insurance Contributions and contributions are not limited by an employee's annual income.

This means that business owners can use pension contributions as a highly tax efficient way to extract profits compared to salary or dividends, which incur Income Tax and potentially National Insurance costs as well.

Once money is in a pension, it is immediately outside of your estate for IHT. As well as funding your own pension, you can also pay into those of other family members who are employed by the business as long as the payments are proportionate to the work they do.

Pension contributions made personally by employees receive Income Tax relief at the individual's marginal rate of Income Tax. Once in a pension fund, the value is generally outside of their estate and free from IHT, regardless of the value of the estate.

## Insurance

A whole of life insurance policy can be written to cover the potential IHT liability your estate may face. The policy can be set up to either pay out on your death or on the death of your spouse or civil partner if they outlive you.

These policies are normally written in trust. This allows the trustees to claim the proceeds on death outside of your estate and pass them to your chosen beneficiaries free of IHT. The proceeds can then be used to pay the IHT bill – or offset the majority of the tax due – if your estate has increased further in value.

Questions to discuss with your Origen adviser

Should I provide insurance for the IHT liability so that the full value of my estate can pass to my chosen beneficiaries?



### How it works

Neeve and Pat would like the value of their estate to pass to their two children when they both pass away. They can expect an IHT charge of £175,000 on their estate after all allowances have been used. They do not want to gift any capital at this time or take too much risk with their investments and would prefer to provide their children with a 'means to assist' with the payment of any potential tax.

Neeve and Pat set up a whole of life policy that will provide cover of £200,000 on second death. The policy will provide cover beyond what they need, but does mean any increase in property prices or growth in investments will be covered and their position can be reviewed again in the future.





## Comparing the options

Some of the options that are available to you for reducing your IHT liability are quicker and easier than others to implement. However, you may need a more complex option because of your situation.

Across these two pages we compare the key features of the main options, which you may find useful in your discussions with your Origen adviser.

Complexity	Low		
	Exempt gifts	Lump sum gifts	Whole of life
Timescale for IHT relief	Immediate	Seven years	Immediate
Benefits	Gifts immediately tax free	Recipients can enjoy the gifts immediately	No investment risk
	Simple		Proceeds are generally IHT free
	Low risk of future change		
Drawbacks	May have little impact on large estates	Loss of access to assets	Premiums can be expensive for retirees and may require medical underwriting
	Records of regular gifts should be kept	Loss of control of assets	Reviewable policies can see significant future premium increases
			Policy may not fully cover a future tax bill

Moderate				Mod-high	
Gift trusts	Discounted gift trust	Loan trusts	Pension contributions	Business property relief	Family Investment Companies
Seven years	Entire value of gift outside estate after seven years	Balance of loan remains part of estate, growth is IHT free immediately	Immediate	Two years, but assets must be held on death	Grow outside of estate on day 1. Ability to gift Directors Loan, 7 year rule applies
Can retain control of investments	Can retain control of investments	Can retain control of investments	Can retain control of investments	Full IHT relief after a 2 year period	No restriction of level of initial contribution/gift. Can retain control of investments
Can decide who benefits/when they receive funds	Can decide who benefits	Can decide who benefits / when they receive funds	Access to tax free lump sum and income in retirement	No loss of access to assets	Can decide who benefits / when they receive funds
	Can retain right to future lifetime withdrawals	Retain access to original loan capital	Outside of estate on death for IHT purposes		Ability to achieve further growth
Trustees have ongoing duties / investments require management	Trustees have ongoing duties / investments require management	Trustees have ongoing duties / investments require management	Restricted access to capital until pensionable age	BPR qualifying assets can be high risk / illiquid	Ongoing accountancy fees
No future access to assets gifted into trust	Funds can normally only be paid to beneficiaries following the death of the settlor(s)	Balance of the loan is still part of the estate and may be subject to IHT	Withdrawals in excess of tax free cash are fully taxable at marginal Income Tax rate	Assets must be held until death to qualify	Investment Risk
Trust and tax rules may change in future			Investment risk	Tax rules may change in future	

## Have you made a Will?

Of course, no one likes to think about the time when they're no longer around. However, it's vital to make a Will so that, after your death, your assets are distributed according to your wishes.

Recent research suggests that 1.5 million Brits aged 65-74 have not made a Will. This means that, if they die, their estate will be distributed according to intestacy rules. Usually this means that only their spouse or civil partner and some other close relative can inherit. As a result, it can be very stressful for loved ones left behind, particularly for an unmarried partner.

While some people choose to write their own Will, we recommend using the services of a solicitor. As specialists in this area, they're well placed to advise you.

Making a Will shouldn't be a 'one time only' event. It's important to update it from time to time, particularly after any significant life changes, such as the birth of children and grandchildren, divorce, remarriage, or death of a spouse or partner. It's a little known fact that marriage revokes your Will, meaning you need to write a new one.

Keep a copy of your Will with your other financial papers – your solicitor can also keep a copy – so it can easily be found.

## Lasting/Continuing Power of Attorney

A Lasting Power of Attorney (LPA), as it's called in England and Wales, or Continuing Power of Attorney as it's known in Scotland, is a legal process that enables you to appoint a person you trust to look after your financial affairs if you're unable to do so, for example, if you develop dementia. You can also make a separate Power of Attorney for health and welfare, and many people opt to arrange both.

The person you appoint can be a relative or friend, and you can appoint more than one person. With these documents in place, if you lose mental capacity to make decisions on financial matters, your attorney/s can make decisions for you. Your attorney has a legal duty to act in your best interests.

It's worth making an LPA at the same time as you make a Will to save money and prevent distress further down the line.



## How Origen can help

Origen is one of the UK's leading national financial advisers, with a 130-year history of advising clients. We have received numerous awards, including Retirement Planning Advisory Firm of the Year for the past 10 consecutive years.

### We're specialists in:

- Growing and preserving your wealth
- Inheritance Tax and estate planning
- Business planning and protection
- Planning for retirement
- Investment advice
- Financial protection for you and your family

### What you can expect from us:

- We give you the knowledge and understanding you need to make the right financial decisions at the right time.
- We are transparent in everything we do and say.
- We look ahead to make sure you are prepared for changes in the financial landscape.
- All our advisers are highly trained and are supported by a team of specialists, so whatever your financial needs we will do our best to help.
- We're committed to protecting your and your family's wealth and overall financial wellbeing in the long term.

## Let's talk

If you're ready to discuss your Inheritance Tax needs, or if you have a question about any aspect of personal or business financial planning, please call us on **0344 209 3925** or email **[clientservices@origenfs.co.uk](mailto:clientservices@origenfs.co.uk)**

Calls are charged at your phone company's basic rate. All calls are recorded for business purposes.



To find out more about our services, please contact us on:

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