

What is Estate Planning?

In the UK when you die you have to account to the tax office (HMRC) for your worldwide assets and liabilities. In essence, this is a statement about your finances upon which your estate may have to pay inheritance tax (IHT) or “death duties” as they used to be known. If you have a surviving spouse who inherits your estate, no tax will be due as legally spouses belong to one another; for richer, for poorer. It is only once both parties of the marriage have died that a final ‘reckoning’ of the estate will take place and taxes applied.

An estate includes your worldly possessions of material value, not sentimental value (though the two are not mutually exclusive). An antique, piece of art, wine collection or classic car all are likely to have a value and if you have been prudent you will likely have insured these assets against theft, damage or loss – so your household insurance policy will act as a check for HMRC. The net value of the estate is what is subject to tax (the value of assets less any liabilities, loans, mortgages, debts and taxes etc).

The “Nil Rate” Band

Everyone is entitled to a minimal exemption or no tax on an estate. This is the first £325,000 known as the nil rate band. This is an allowance that can be passed on between spouses, so is normally doubled for a married couple to £650,000. The allowance is subject to change by Government. It was last increased in 2009 by Gordon Brown from £312,000; and the current Chancellor has frozen it until April 2031 (though this is always subject to change).

There are other allowances as well, and estate planning (or at least ‘good estate planning’) involves organising your affairs in a way that minimises inheritance tax. It should be said that precision in planning involves some degree of luck too. We do not know when you will die or what tax rates and allowances will be in the future. We also won’t know how much end-of-life care (if any) was paid for. However, with thoughtful and careful regular (annual) reviews that take account of your circumstances and Government policy, we can make a really good attempt at ensuring that your chosen beneficiaries and charities receive what you intend and that HMRC are not the largest recipient of your lifetime’s work.

There are a number of main features to estate planning, which I will briefly outline here:

1. **Spend it** – if it’s gone it cannot be taxed, but that doesn’t mean buying things of value. Buying houses doesn’t solve the problem
2. **Gift it** – you can gift substantial sums, with a catch – that you must live for a full seven years for the gift to be completely excluded from the calculations. You will (or more accurately - your executors will) also need to be able to prove the date of the gift

3. **Give to charity** – this potentially can reduce the tax rate from 40% to 36% if your gifts to charities are 10% or more of the estate value. Any gift to charity is exempt
4. **Hold your assets in a way that they are exempt.** This isn't often practical or suitable for everyone, but woodland (for example) is exempt; there are special exemptions for farms and business owners. The latter is more popular now and builds on 50 years of legislation that means that shares held in a private company for at least two years at the point of your death will be exempt. This is known as Business Relief and there are now some excellent (and some not so good) options to consider. The main advantage is that you retain control of the money, you can have it back if needed, unlike a gift or use of a Trust
5. **Trusts** can be used, but aren't the solution that most people believe them to be. Trusts pay taxes and need proper accounting to HMRC as well as being properly registered as a legal taxpaying entity. You are not permitted to benefit from a Trust, it isn't a type of personal bank account. The purpose is primarily to secure funds for future generations, as the Trust owns them and not individuals, in the event of your children and future heirs having marriages or businesses that "fail" (end) the money is not theirs so cannot be considered in any settlement. Most Trusts essentially protect your family wealth from bad decisions. The exception is really a special trust for someone who is vulnerable and needs their finances protected and managed for them (safe from outside influences)
6. **Insure the tax bill** – you can arrange life assurance to meet the tax bill. This can be very effective, but will be more expensive as you age. Upon death, the life assurance is paid into Trust (falling outside of your estate) and then used to pay HMRC. This option has arguably the most flexibility because should rules alter and IHT is abolished or changed in a way that your estate is extremely unlikely to pay it, you can simply cancel the cover.
7. **Do the obvious** – your Will (and Power of Attorney) are vital documents, without these you compromise everything. Your spouse and children are left with a lot of work and financial stress that could have been very easily avoided. Prepare an outline of your funeral requirements, ultimately a funeral isn't for you, it's for the survivors, but it is certainly about you

Estate Planning done well goes beyond simply using allowances and exemptions, all of which have practical limitations. Educating your family about how to handle money wisely and to get their financial planning in good order is part of a valuable experience, that is probably life changing. Having clear discussions about how you wish to help your family and beneficiaries is vital. A great deal of history, drama and film give us plenty of cautionary tales of families and money – where there's a Will there's a crowd. To acknowledge the emotional aspects are important too – often planning is done when there is considerable emotional stress, perhaps due to a terminal illness being diagnosed.

Inheritance tax generally remains the most loathed of all taxes, despite the fact that most estates do not pay it. HMRC tends to raise about 1% of all taxes as inheritance taxes. The actual amount tends to increase each year largely due to the value of assets increasing. Most people do not plan as well as they could and pay more tax than necessary.

Reference:

HMRC inheritance tax receipts: <https://www.gov.uk/government/statistics/inheritance-tax-liabilities-statistics>

HMRC form about gifts: <https://www.gov.uk/government/publications/inheritance-tax-gifts-and-other-transfers-of-value-ih403>

Online Inheritance tax calculator: <https://www.ihcalculator.com/>

HMRC guide to IHT: <https://www.gov.uk/government/collections/inheritance-tax-detailed-information>

HMRC guide to IHT and Trusts: <https://www.gov.uk/guidance/trusts-and-inheritance-tax>

HMRC Trusts manual: <https://www.gov.uk/hmrc-internal-manuals/trusts-settlements-and-estates-manual>

IHT Lessons from the film “Knives Out”: <https://www.solomonsifa.co.uk/8863-2/>