

Portcullis Wealth Retention Ltd Guide to Estate Planning



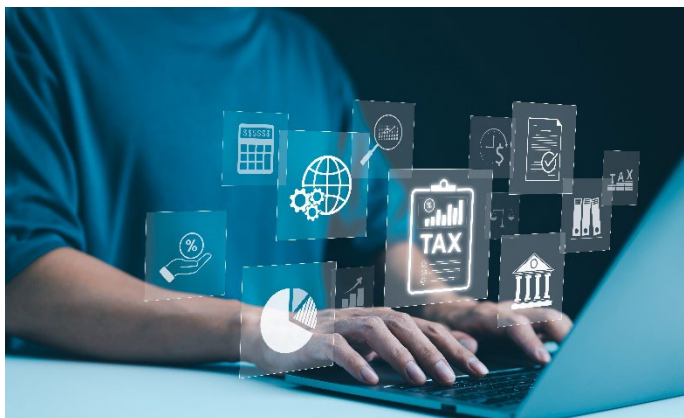
James A Caviel DIP PFS MSWW

Portcullis Wealth Retention Ltd

Portcullis Wealth Retention Ltd

Technical Guide: Inheritance Tax (IHT) Avoidance

BACKGROUND:



As specialists in Estate Planning and Inheritance Tax (IHT) Avoidance we have been asked repeatedly over the years for a simple guide to avoiding or reducing inheritance tax.

As the author has said on many occasions Inheritance Tax is in many ways a voluntary tax, there are legitimate steps you can take to reduce, avoid or irradicate an inheritance tax liability all together if you actively plan to do so. Sometimes clients will occasionally worry about the moral implications of avoiding tax.

In this regard we offer a poignant, highly relevant and infamous quote. From the 1936 case from the Court of Appeal - **Inland Revenue Commissioners (hereafter HMRC for brevity) vs Duke of Westminster**.

A legal challenge brought to the court of appeal by HMRC against the Duke of Westminster regarding his use of tax legislation at the time to reduce his taxable income. The case is an often cited because the HMRC lost and for the often-repeated decision that the presiding judge, Lord Tomlin, famously said:



“Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”¹

¹ Source: <http://www.taxresearch.org.uk/Blog/2012/08/10/the-duke-of-westminster-is-dead-long-live-the-duke-of-westminster/@10.02.2025>

Although this ruling was attractive for others seeking to avoid tax legally by creating complex structures, it has since been weakened by subsequent cases where the courts have looked at the overall effect.

An example of the courts' later, more restrictive approach was the Ramsay principle where, if a transaction had pre-arranged artificial steps that served no commercial purpose other than to save tax, the proper approach was to tax the effect of the transaction.

Therefore, when planning for tax avoidance, knowledge of the law and its practical application should be high on the list of desirable attributes of the advisers you decide to engage.

With over thirty years success in Estate Planning, we believe Portcullis Wealth Retention Ltd is in a very strong position to provide its clients both prospective and existing a very high level of comfort in the suitability, legality and appropriateness of its recommendations.

FISCAL DATA TO PONDER:



The 2024 Autumn budget has brought Inheritance Tax into sharp focus for many and Labour are being touted as the culprits for the increased taxation of wealth.

However, the truth is that IHT allowances have remained frozen since the coalition budget of 2009.

The fiscal drag of this freezing of allowances has changed the landscape profoundly, the annual tax burden has risen from £2.4 billion to £7.5 billion in 2023-24 and according to the Office of Budget Responsibility (OBR) will rise to £9.7 billion p.a. within the term of this parliament ².

² Source: [@10.12.2024](https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/inheritance-tax%2D28)

Further with the recent Labour Autumn Budget in October 2024 and the announcement that pensions will come within the scope of IHT from 6th April 2027, the halving of certain long-standing reliefs for farmers, in the form of agricultural property relief then its widely accepted that things are set to get a lot worse.

It is crystal clear that whatever the political leaning of the Government the incumbent Chancellor is going to see Inheritance Tax as a viable source of income for the exchequer, and they are likely to seek to mine this vein for the foreseeable future.

Why? Let's pause for a moment and consider the bigger picture in terms of the next 25 years, in the UK as baby boomers age, their wealth will be transferred to the next generation.

The OBR estimates a total of **£5.5 trillion** of assets will transition from the baby boomers (b 1946 – 1964) to the next generations:

Generation X [b. 1965-80]	Generation Y aka "Millennials" [b.1981 - 1995]
Gen Z [b.1995-2010]	Alpha [b. 2010-25]

If we add into the mix the wealth of Gen X, some of whom will be in their 80's within the next 25 years and the figure becomes even more staggering.

Using Office of National Statistics (ONS) data ³ and the current allowances for inheritance tax there is therefore a pot of money to be redistributed through taxation, measuring in the trillions, in the same time frame.

That's why successive governments have been very quietly leaving inheritance tax allowances and rules in stasis because they are looking to very quietly and stealthily increase the Exchequer receipts from Inheritance Tax, by doing nothing.

Whilst Portcullis appreciates the need for taxation, it's the fact that this wealth is often accumulated AFTER tax has been applied, usually in the form of income tax,

national insurance, corporation tax, capital gains tax, VAT, stamp duty and other often overlooked taxes such as those on fuel, insurance and flights.

Therefore, Portcullis Wealth Retention Ltd unashamedly believes that Lord Tomlins famous statement from nearly 90 years ago, is as true today as it was then.

Given this background unsurprisingly we have seen an increased interest in how IHT exemptions and gifting may be utilised including the use of pension income and lump sums.

The good news is

You have asked for some help and guidance, which is why you are reading this document

We have successfully been providing IHT & Estate planning advice now for over 30 years

If you are proactive, know the tools and allowances to use, then the potential tax liability on your estate for your children and future generations can be reduced or eradicated all together.

This Technical Guide is simply a broad overview of the various planning opportunities available to UK taxpayers.

It's crucial for any planning to be successful the reader should seek professional advice from a suitably qualified and experienced person, we hope that will be us!



³ Source: <https://www.ons.gov.uk/> @ 09.02.2025

TAX RATES & MAIN EXEMPTIONS:

TAX RATES		
Nil Rate Band [NRB] ^{4, 5, 6}	IHT due on a Chargeable Lifetime Transfer [CLT] over the NRB	IHT due on Death over the NRB
£325,000	20%	40%
Residence Nil Rate Band [RNRB] ^{7, 8}	IHT due on CLT more than RNRB ⁹	IHT due on Death over the NRB ¹⁰
£175,000		40%

MAIN EXEMPT TRANSFERS	
	Maximum £
Gifts to a UK domiciled spouse	No limit
Gifts to a Non-UK domiciled spouse ¹¹	£325,000 ¹¹
Gifts to charities	No limit
Gifts to political parties	No limit
Annual exemption	£3,000
Small gifts ¹²	£250
Normal expenditure out of income	No limit
Gifts in consideration of marriage	(see below)
Parents	£5,000 each
Grandparents and bride/groom to each other	£2,500 each
Any other person	£1,000

⁴ The NRB will remain frozen at £325,000 until the next parliament. This will be 2028-29.

⁵ When the deceased has been predeceased by a spouse who had not used all their own NRB on their earlier death, the unused percentage on first death can be transferred to enhance the NRB of the surviving spouse on second death. The maximum percentage that can be transferred is 100% which would double the NRB available.

⁶ If the net value of the estate (after deducting any liabilities but before reliefs and exemptions) is above £2 million, the additional nil-rate band will be tapered away by £1 for every £2 that the net value exceeds that amount. The taper threshold at which the additional nil-rate band is gradually withdrawn will no longer rise in line with CPI.

⁷ The RNRB is only available to offset against the value of a residential property that is (or has been previously) used by the deceased as their main residence and which is transferred on death to a lineal descendant, or the spouse or civil partner of a lineal descendant.

⁸ When the deceased has been predeceased by a spouse who had not used all of their own RNRB on their earlier death, the unused percentage on first death can be transferred to enhance the RNRB of the surviving spouse on second death. The maximum percentage that can be transferred is 100% which would double the RNRB available.

⁹ The RNRB is only available on death – it cannot be offset against lifetime transfers of a main residence.

¹⁰ The RNRB, which is in addition to the normal ('any assets') NRB, is set off against any chargeable transfers of a main residence before any of the normal NRB is used up.

¹¹ This £325,000 exemption applies to cumulative transfers. It is therefore necessary to consider previous gifts and transfers to a non-UK domiciled spouse to determine whether any of this exemption remains. It is also possible for a non-domiciled spouse to instead make an irrevocable election to be treated as UK domiciled for IHT purposes.

¹² The gift must be outright, not a gift into trust.

WAYS TO REDUCE INHERITANCE TAX

As already mentioned, it is possible to reduce the amount of Inheritance Tax due when you die, so you can leave more to your loved ones. To avoid inheritance tax (IHT) legally, there are several strategies you can use:

MAKE A WILL:	Proper estate planning ensures assets are distributed in a tax-efficient way.
SET UP TRUSTS:	Placing assets into a trust can remove them from your estate, reducing or eliminating IHT liability.
USE LIFE INSURANCE:	A policy can cover the IHT liability, ensuring your family isn't burdened.
MAKE LIFETIME GIFTS:	You can gift up to £3,000 per year (or £6,000 for couples) tax-free, with additional exemptions for small gifts, wedding gifts, and regular payments from income.
PASS YOUR HOME TO CHILDREN OR GRANDCHILDREN:	This can qualify for additional tax exemptions.
SPEND YOUR WEALTH:	Reducing the value of your estate by enjoying your money can minimize IHT.
LEAVE YOUR ESTATE TO A CHARITY:	Not everyone knows this but including charitable gifts in your Will could decrease the amount of inheritance tax paid on your estate!

Let's look at each of these in a little more detail:

WRITE A LAST WILL & TESTAMENT:



Making a will is one of the simplest and easiest ways to make sure your money goes to the people you want, for the reasons you choose. It allows you to choose how your assets will be managed on death, allowing you to plan for and minimise your inheritance tax bill.

If you do not make a will, the government will decide how your assets are distributed under the rules of intestacy. This is unlikely to be the most tax-efficient method or indeed satisfactory method of estate distribution.

Here are some of the benefits of making a Will:

Control over your assets - writing a will allows you to retain control over how your assets are dealt with to ensure your loved ones are provided for.

A will is essential if you are not married or have what we refer to as a blended family and you want to ensure certain assets stay within the family bloodline.

Not as robust as a trust framework it will enable assets to be passed on to specific beneficiaries.

A will can also be written in a certain way to protect the interests of a common law partner during the remainder of their lifetime should you predecease them, but ensure any assets, such as a house, is then inherited by your chosen beneficiaries after your partner's death.

Tax-efficiency - wills are a great way to put your tax affairs in order and legally shelter your assets from inheritance tax. For example, you can use your Will to make gifts that use up your inheritance tax allowance or to set up trusts.

You can also make sure that all the available inheritance tax exemptions are used at the right time. Ensuring you don't pay more inheritance tax than you need to.

Flexibility - you can make changes to a Will after somebody has died. This is known as effecting a deed of variation. This can help reduce inheritance tax, particularly where the intended beneficiary already has an inheritance tax liability.

For example, many grandparents leave their estate to their children. However, if their children are already financially sufficient and do not require the money, it will just sit in their estate untouched.

On their death, inheritance tax may be paid on this money, this is where a deed of variation comes in, it allows you to change the intended beneficiary.

You could, for example, pass the assets straight onto the grandchildren, held in a trust until they are old enough. This would mean that the money goes straight to the grandchildren without paying inheritance tax.

SET UP TRUSTS



When you read the headlines that the super-rich have saved millions in tax on death, or old wealth passed down generations with little or no IHT, I can guarantee at the heart of the planning will be complex trusts.

The great news is that these are not the exclusive domain of the super-rich, they are available to most people, the key is working with an Estate Planner that has the knowledge and experience to help you navigate the complexities of these legal frameworks to your benefit.

A trust is effectively a separate legal entity. If you put assets into a trust, provided they meet specific legal requirements, they no longer belong to you.

As a result, assets in a trust are not included in your estate for inheritance tax.

IMPORTANT NOTE ANY GIFT INTO TRUST IS SUBJECT TO THE 7-YEAR RULE, SO EARLY PLANNING IS ESSENTIAL TO GAIN THE MAXIMUM BENEFIT.

HOWEVER ONCE ESTABLISHED MODERN TRUST HAVE A SHELF LIFE OF 125 YEARS. THEREFORE, ONCE IN PLACE THEY SHOULD PROTECT YOUR WEALTH FOR SEVERAL GENERATIONS TO COME.

Using a trust provides a more sophisticated way to minimise your inheritance tax liability. Depending on the type of trust, it allows you to retain some or full control over how the money is used and who benefits.

However, you should note that trusts have their own tax charges and costs.

Before setting up a trust, you should consult with an a suitably qualified and experienced Estate planner or Independent Financial Adviser who will be able to advise on the right type of trust to meet your needs.

They will determine the best type to minimise inheritance tax whilst keeping other taxes and charges to a minimum.

USE LIFE INSURANCE

If you have a life insurance policy and die, your beneficiaries will receive a payout. If you haven't placed the life in trust, then inheritance tax will be due.

Your life insurance policy needs to be written 'in trust' to separate it from your estate to avoid any inheritance tax. If done correctly, the net result is that your beneficiaries will receive your whole estate without a tax deduction.

You can either set up a 'term' assurance policy or a 'whole of life' policy. A term assurance policy will only cover you until a specific age. If you die within the term, it will pay out. A whole-of-life policy will pay out when you die, irrespective of when you die.

Term assurance policies are generally lower cost, as the risk of your death occurring within the term is not guaranteed. Of course, the longer the term of the policy, the higher the cost. Whole-of-life insurance policies are higher cost, but they are guaranteed to payout when you die.

The downside of using life insurance is the cost. It can become expensive the older you get. The upside is that insurance provides a simple solution whilst still leaving you in full control of your assets.

Later in this guide we look at some examples of combining trusts with pensions, this is topical due in part to the government's announcement to subject pensions to Inheritance Tax on death from April 2027.

But trusts and trust planning has been around for some years. At Portcullis we firmly believe the most important tool in the Estate Planners toolkit are Trusts.

There are many types of trust and all have various nuances that can be used in the appropriate situation to help mitigate tax, ensure wealth flows down the family bloodline over generations and can also potentially protect wealth from a range of external negative factors such as divorce, bankruptcy and long-term care fees.

As a firm we refer to trust planning as the creation of a Family Controlled Trust Framework (FCTFW).

IMPORTANT NOTE: All advice relating to Trust frameworks will be subject to written tailored advice and fees, that will need to be understood and agreed BEFORE the FCTFW is established. Not all these potential benefits can be secured as a wide range of individual factors will determine the best package of trusts and therefore potential benefits will be dependent on a range of factors this guide cannot cover adequately

MULTIPLE TRUSTS - SAME DAY ADDITIONS, RELATED SETTLEMENTS AND RYSAFFE PLANNING

Trusts created on the same day will be treated as related settlements for periodic charges Anti-avoidance legislation exists to limit the benefits of multiple small trusts (pilot trusts) receiving same day additions

Making a series of gifts on separate dates could limit periodic charges (Rysaffe arrangements) Jump to the following sections of this guide:

Splitting a large gift across several different trusts will mean each trust has its own nil rate band for calculating periodic charges. However, the benefit is limited as the value of the gifts into each trust can affect the periodic charges on the other trusts.

Related settlements occur where two or more trusts are set up on the same day by the same settlor. The rules exist to limit any tax advantage by creating multiple trusts.

When calculating periodic charges, the initial value of all the other trust(s) created on the same day will be added to the value of the trust being assessed at each tenth anniversary.

The shorthand method of multiplying the excess above the available nil rate band by 6% cannot be used where there are related settlements or same day additions.

RYSAFFE PLANNING

Example

Graham created four discretionary trusts on the same day and gifts £100,000 into each of them. There was a CLT of £400,000 and IHT of £15,000 (£75,000 x 20%) was paid.

At the 10th anniversary each trust is NOW valued at £150,000. There have been no exits or additions to the trusts.

Notional tax @ 20%	£25,000
Effective rate (£25,000/£450,000 x 100)	5.55%
Actual rate (5.55% x 30%)	1.67%
Periodic charge (£150,000 x 1.67%)	£2,500

Periodic charge

Value of trust #1	£150,000
Value of related settlements (3 x £100,000)	£300,000
Total	£450,000
Less nil rate band at 10 year anniversary	(£325,000)
Chargeable amount	£125,000

This calculation is repeated for each of the four trusts giving a total periodic charge of £10,000.

Had the total amount been added to a single trust the periodic charge would be:

Trust value	£600,000
Nil rate band	(£325,000)
Chargeable amount	£275,000
Periodic charge (£275,000 x 6%)	£16,500

SAME DAY ADDITIONS

Similar rules exist where new property is added to two or more existing trusts on the same day. The initial value of all property added on the same day to any trusts created by the same settlor is aggregated with the current trust value when calculating periodic charges.

Rules were introduced 10 December 2014 to prevent the use of pilot trusts to limit the impact of trust IHT charges.

This involved the creation of multiple small trusts, often with just a £10 note. Later a much larger amount was added to each of the trusts. This was often a lump sum paid from the settlor's will or lump sum pension death benefits.

Each trust has its own nil rate band for periodic charge calculations. But only the initial value of any related settlements (number of pilot trusts x £10 starter gift) was included when calculating future IHT charges and not the property which was subsequently added to those settlements.

The new same day additions rules limit the effectiveness of this type of planning. Where the added property is spread across multiple trusts the value added to each trust is included in the periodic charge calculation.

RYSAFFE ARRANGEMENTS.

If trusts are created on separate days, it avoids them being related settlements. This is often referred to as Rysaffe planning following a tax case which involved a series of gifts on consecutive days.

Each trust will have its own nil rate band. However, each time a trust is created there will be a chargeable transfer which reduces the available nil rate for each trust which follows it.

Examples

William created four discretionary trusts over four days and pays £100,000 into each of them.

Trust #1 is a CLT of £100,000 – no tax as within the available nil rate band (£325,000)

Trust #2 is a CLT of £100,000 – no tax as within the available nil rate band (£225,000)

Trust #3 is a CLT of £100,000 – no tax as within the available nil rate band (£125,000)

Trust #4 is a CLT of £100,000 – £15,000 IHT payable on excess above the available nil rate band (£25,000)

At the 10th anniversary each trust is valued at £150,000. There have been no exits or additions to the trusts.

Total periodic charges across all 4 trusts	£9,000
Trust #1	
Value of trust #1	£150,000
Less available nil rate band at 10 yr ann.	(£325,000)
No periodic charge as within the NRB	£0.00
Trust #2	
Value of trust #2	£150,000
Less available nil rate band at 10 yr ann.	(£225,000)
No periodic charge as within the NRB	£0.00
Trust #3	
Value of trust #3	£150,000
Less available nil rate band at 10 yr ann.	(£125,000)
Chargeable amount	£25,000
Periodic charge (£25,000 x 6%)	£1,500
Trust #4	
Value of trust #4	£150,000
Less available nil rate band at 10 yr ann.	(£25,000)
Chargeable amount	£125,000
Periodic charge (£125,000 x 6%)	£7,500

Compared to the periodic charge of £16,500 William would have paid if a £400,000 investment was paid into a single settlement, significant savings have been made.

LOAN TRUSTS

This type of planning can also be effective when used with loan trusts. There is no chargeable transfer with loan trusts which will reduce the nil rate band of each subsequent trust.

This is because money is lent to the trustees rather than gifted. If the settlor has not made any other CLTs, each loan trust would have a full nil rate band for calculation of periodic charges.

MAKE LIFETIME GIFTS



Gifting is an often overlooked but highly effective way of reducing the value of your estate for inheritance tax. There are no limits on the number of gifts you can make.

Giving away assets while you are alive still requires careful planning. You need to work out how much you can afford to give away whilst still ensuring that you have enough to meet your own needs.

Depending on how you structure the gift will determine how much inheritance tax is saved.

There are two forms of gifting, known as “potentially exempt transfers” and “chargeable lifetime gifts”.

POTENTIALLY EXEMPT TRANSFERS (PET)

A potentially exempt transfer is where you make an outright gift (i.e., you do not transfer money into a trust).

You can make unlimited gifts in this way without any immediate inheritance tax charge.

If you survive for seven years from making the gift, it falls outside of your estate and there is no inheritance tax liability.

If you die within seven years, then some or all the gifts will be included in your estate for inheritance tax.

The amount that is subject to inheritance tax will depend on when the gift was made. If it was within 3 years, then the full amount is subject to inheritance tax.

If it was between 3 – 7 years ago, then only part of the gift is subject to inheritance tax.



Years between gift & death	% of IHT paid on gifts (Effective tax rate %)
< 3	100% (40%)
3 - 4	80% (32%)
4 - 5	60% (24%)
5 - 6	40% (16%)
6 - 7	20% (8%)
7 +	Nil

CHARGEABLE LIFETIME TRANSFERS

A gift that is not a potentially exempt transfer, is known as a chargeable lifetime transfer. These usually are gifts made to discretionary trusts and corporations.

You can make chargeable lifetime transfers of up to £325,000 every seven years without any immediate tax implications.

Any amount more than this will attract an immediate inheritance tax charge of 20%.

If death occurs within seven years, then the cumulative value of the chargeable lifetime transfers will need to be calculated.

Any amount more than £325,000 will attract a further inheritance tax charge of 20%.

GIFTS OUT OF INCOME

If you receive more income than you spend, you can make a gift from your surplus income **without any inheritance tax charge**. The exemption under section 21 of the Inheritance Act 1984 allows for an individual to make exempt gifts, reducing their taxable estate, if it can be demonstrated that the gifts meet 3 conditions:

It forms part of the individuals (settlor's) normal expenditure

It was made from their income

It doesn't cause a reduction in the settlor's standard of living

If all these conditions are met, then there is no limit on the amount which can be gifted and immediately exempt from IHT.

HMRC will usually consider a payment (in this case, a gift) to be regular or habitual if it has been made across three or four years, with the intention of continuing to make further, similar payments.

However, even if the individual should die after only one such gift, it's possible to establish that it meets this requirement, if it can be shown that it was your client's intention to make the gift regularly on a habitual basis.

Documentary evidence of intention is therefore important. The facts of each case will be considered by HMRC on its individual merits.

Gifts do not have to be of a fixed amount and can vary from year to year, but generally the individual should evidence an established pattern over a few years to be considered habitual or regular.

Reduction in standard of living

The individual's normal standard of living is assessed at the time of the gift(s).

If we refer to the previous dictionary definition used by HMRC, standard, regular, typical, habitual or usual, it will need to be demonstrated the pre and post standard of living was not impacted by the gift claiming the exemption for.

Gifts will not qualify for the exemption if the individual must resort to capital to meet their normal living expenses e.g. mortgage payments, bills, other loan repayments etc.

YOU CANNOT GIVE AWAY ALL YOUR INCOME AND RELY ON YOUR CAPITAL TO FUND YOUR LIFESTYLE INSTEAD.

Acceptable income sources:

Pension income	Salary	Investment income
Rental property income	Self-employment	State pension
Savings interest		

Unacceptable source of gifts from capital:

Property income	Premium Bonds	Investments
Savings	Pension pots	ISA's

Considering the exemptions above, we are seeing an increased volume of questions as to how these can be combined with pension income and lump sums.

Firstly, we should clarify that although paid tax free and as a lump sum, pension commencement lump sums are still classed as income payments (albeit tax free) and as such could consider normal expenditure rules.

IS IT POSSIBLE TO GIFT A LUMP SUM FROM A PENSION SCHEME?

Yes, it is possible to make a lump sum gift. How it will be treated for IHT will depend on whether the gift is considered exempt or not.

If the gift is not exempt and it is made outright to say an adult child, this gift would be a Potentially Exempt Transfer (PET).

There is no IHT liability at the time the gift is made, and if the person making the gift survives for seven years, then the PET falls out the member's estate for IHT purposes.

If the member dies within the seven-year period, the value of the gift will use up part of the nil rate band (currently, £325,000) if not already utilised. If taper relief applies, then after three years the gift value is reduced but still considered for IHT purposes.

Can gifts of Pension Commencement Lump Sum (PCLS) meet the criteria for normal gifts out of expenditure exemption? It depends. The criteria to meet the gifts out of normal expenditure as set out above must be met. Depending on how a client has taken their PCLS will of course have a bearing on how easily or not it is to meet the criteria. Remember, the gift is supposed to be regular and/or habitual.

What is regarded as 'income' from a income drawdown plan or "pension" For clarity we are discussing a type of pension that's referred to as a 'Money Purchase' pension (also known as 'Defined Contribution' pension). This is an insurance plan that accepts regular or one-off contributions.

The "pension" allows Tax Efficient Regular Income Options (TRIO). Each of the three options provide automated regular payments:

PCLS only (i.e. £100,000 taken over say 36 months)

PCLS + full income (i.e. 25% of the payment will be tax free up to the PCLS being exhausted; the rest of the payment, 75%, will be taxable at your marginal rate)

PCLS + some income (i.e. 25% of the payment will be tax free up to the PCLS being exhausted; you can also take up to 75% of the residual fund and this will be taxable at your marginal rate)

In these instances, it is likely that these will be classed as 'income' and therefore any gifts made from these amounts may meet the gifts out of normal expenditure exemption providing all three of the conditions above are met.

If those conditions are not met, then it may be possible to utilise other exemptions i.e. Annual exempt amount (£3,000) or the gift of the withdrawal would be classed as a PET.

Examples:



FAILED GIFT (PET)

Priscilla has made no previous gifts but has read about the IHT changes coming on 6th April 2027.

She decides to take her full Pension Commencement Lump Sum (PCLS) of £50,000 and give it to her children on 7th March 2025.

Priscilla dies shortly after making the gift.

Her estate is valued at £400,000.

Priscilla's Executors consider making a claim for gifts out of normal expenditure.

However, it is unlikely this would meet the conditions explained above, as this was not a gift out of normal expenditure. Priscilla had made no previous gifts or intended to make any further gifts so it's unlikely be considered regular or habitual by HMRC. In this circumstance, the gift is more likely to be considered a failed PET, due to Priscilla not living 7 years from the date of the gift.

If Priscilla had intended to take her PCLS over say, a five-year period where £10,000 a year was paid out, she gifted that amount each year to her children and her standard of living was not impacted, then this is more likely to meet the conditions.

GIFT OUT OF NORMAL EXPENDITURE:

Bridget aged 57 is married with four children she has the following assets:

£1.8m pension with Fixed Protection 2012
£1.5m house
£500,000 investments

She has a salary of £150,000 each year (which fluctuates depending upon bonus received).

Her Bonus is payable in April each year.



Her salary provides her with sufficient income to cover her standard of living. Bridget is planning to retire in the next few years, but would like to start some IHT planning, she is worried about the recent announcements that pension money left where the individual dies after 6th April 2027 will fall within the IHT net.

Her four children are at university, and she would like to start to provide them with regular payments over the next five years. Bridget's adviser suggests she may want to consider taking her PCLS over the next five years – which will provide £90,000 a year to be divided between the children.

Bridget's intention is that this payment will be made 4 times a year to allow her children to pay for their university fees and cost of living. Each time a payment is made, her adviser suggests that she records each payment.

After 5 years, Bridget has not retired although has reduced her hours. She has begun to draw her pension although does have excess income. So, she again decides to provide yearly gifts to her children. The value of these gifts will vary as Bridget has decided to use her bonus to provide those gifts.

Due to the nature of Bridget's gifting meeting all three conditions for gifts out of normal expenditure, on Bridget's death these gifts will not be included in her estate.



GIFTING INTO A DISCRETIONARY TRUST

Peter is 70, he is retired but is yet to draw his pension as he has a successful property portfolio which is yielding him £60,000 a year.

He has a long-term partner, Alison, but they are not married and do not have any children.

Although Peter does have a niece and nephew to whom he is very close.

Peter has a pension which is currently worth £400,000. Following a recent meeting with his financial adviser, Peter will be taking his PCLS of £100,000. As Peter is concerned about mitigating IHT and ensuring his partner is financially secure after his death, he has set up a discretionary trust, where his partner is named as a beneficiary, as are his niece and nephew.

As the gift into the trust is below the nil rate band there is no immediate IHT charge. Further Peter also has the option to make regular payments into the trust – either utilising the annual gifting exemption of £3,000, gifts out of normal expenditure if all three of the criteria are met or make further lifetime gifts up to the value of the nil rate band – without incurring an immediate IHT liability.

GIFTING INTO A LIFESTYLE TRUST

Alison is keen to undertake some IHT planning following the news that pension pots will soon be subject to IHT, however, she is concerned that she won't have enough money for her later years.

Alison has a healthy pension pot of £1.2 million (IP2014), she has taken her PCLS of £300,000 and now wants to do some IHT planning, her adviser has recommended a Lifestyle Trust.

This trust allows Alison to undertake IHT planning but on a specified date receive access to the value of some or all her investment.

Alison places £300,000 into an onshore single premium bond (Investment Bond) and then assigns the bond into the trust, there is no immediate IHT charge as this is below the nil rate band. Because this is a discretionary trust, Alison does not need to name specific beneficiaries, with her advisers help, Alison specifies that she would like access to 100 policies a year for 10 years.

This means (assuming no investment growth/loss) Alison would have the right to access £30,000 a year if she encashed the policies.

The benefit of the Lifestyle trust is that before the vesting date, Alison can ask the trustees to either allow the policies to:

Vest to her,

Defer the right to receive access to these policies to a future year or.

Ask the trustees to consider making an appointment in favour of a beneficiary.

In year one and two, Alison doesn't need the additional funds so asks the trustees to defer to year five.

In year three, the policy funds vest to Alison, as she needs the money for some expensive travel plans and she encashes them. Because Alison is a basic rate taxpayer, she has no income tax liability.

Record keeping as the exemption is claimed after death it would be prudent for you to keep a full record of any payments for which you intend to claim the 'normal expenditure out of income' exemption. As active clients of Portcullis Wealth Retention Ltd we will provide this letters and evidence as part of the on-going service.

This will allow their LPRs, upon their death, to complete HMRC's form IHT403 (page 6).

This form asks for a breakdown of expenses to justify the claim that their standard of living had not been affected by the gifts made.

Use your gifting exemptions certain gifts are exempt from inheritance tax altogether. These include:

Gifts to spouses anything you give to your spouse during your lifetime or upon death (provided they live in the UK) is free of inheritance tax, this is just one of the many tax planning opportunities for married couples.

Annual exemption – you can legally give away £3,000 each tax year without attracting inheritance tax. If you have not used this allowance, you can carry it forward by one tax year, allowing you to gift up to £6,000. This allowance is per person, so if you are married, you can double this.

Wedding gifts – giving cash gifts to newlyweds is a very common way to avoid inheritance tax. The level of tax relief varies depending on the relationship between the donor and those receiving the gift.

Parents and stepparents can give up to £5,000 tax-free. Grandparents can give up to £2,500, and other relatives and friends can give up to £1,000.

These gifts must be given on or shortly before the date of the wedding or civil ceremony.

GIFTS TO CHARITIES OR POLITICAL PARTIES

There is no limit to the amount of money you can donate to charities or political parties. Gifts to charities in your Will also reduce the Inheritance Tax rate to 36%, provided that 10% of the “net estate” is passed to charity. Your “net estate” is the taxable value of your estate, after your residence/nil rate band and any debts/liabilities have been repaid.

Small gifts of up to £250 are defined as “small gifts”. You can make as many small gifts as you like without any inheritance tax implications. The only condition is that the gift cannot be part of a larger gift.

GIFT WARNINGS:

You may be tempted to think that you can pass on assets for less than they are worth, and this might get around the rules on inheritance tax.

Unfortunately, if you sell an asset for less than its true market value (e.g. selling a property at a discount to your child), then the discount will be treated as a gift & subject to IHT.

Many have tried to get around the inheritance tax gifting rules by ‘giving away’ assets.

However, continue to enjoy their use of them (e.g. giving their home to a child while continuing to live there). This is known as a ‘gift with reservation’. If a gift with reservation occurs, then the gift will still be treated as part of the estate of the deceased, even if they no longer own the asset on death. As such, inheritance tax will be paid.

The only solution to the ‘gift with reservation’ rules is to pay the market rent on the asset after making the gift.

For example, you gift a property to your child at less than market value but pay the market rate of rent to continue living there. This will then classify the gift as a potentially exempt transfer (detailed previously).

PASS YOUR HOUSE TO YOUR CHILDREN



We have already seen above that simply gifting your main residence to your children and continuing to live in it will not avoid IHT unless certain conditions are met.

The rental income in the hands of the beneficiaries is taxable under normal income taxation rules so is unworkable in most cases.

However, there is some good news, a principal residence passed down on death to a direct descendant will qualify for the **Residence nil rate band** – this is an extension of the nil rate band.

This provides you with an additional £175,000 tax-free allowance, however, must be set against your main residence and be gifted to a direct descendent (child or grandchild).

As per the nil rate band, if you die and leave your main residence to your spouse, they will inherit your residence nil rate band.

They will then have two allowances of £175,000, providing them with £350,000.

Combined, each person has an allowance of £500,000 that can be gifted without inheritance tax.

Or, if you die and leave assets to your spouse, they will have an allowance of £1,000,000.

NOTE OF CAUTION:

If your estate is worth over £2 million, the residence nil-rate band will be tapered. For every £2 your estate is over £2 million (after deducting liabilities but before reliefs and exemptions), the residence nil-rate band will decrease by £1. That means that at £2,350,000 your residence nil-rate band will be zero.

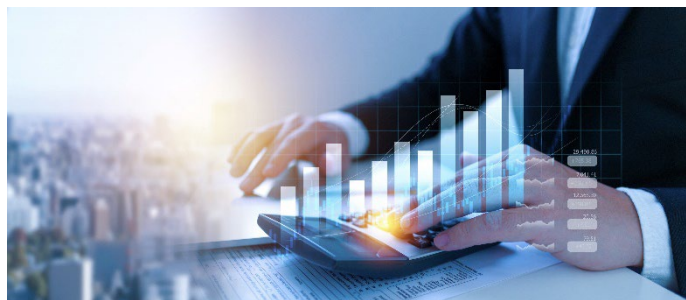
Where death occurs at a relatively young age and a spouse is left that may yet live for some years, there is the potential his or her estate may grow beyond the £2.0 m threshold even when on 1st death the combined estate was worth less than this.

Therefore, we always advise clients to bank their nil rate bands on first death and gift up to their lifetime allowances into a trust to “bank” the tax-free allowance.

The trust assets are then “loaned” to the surviving spouse on a lifetime basis so there is no financial detriment to them.

If the estate grows more than £2.0 m by the time the second spouse dies then you will have already banked the £500k tax free allowance and it is therefore preserved, any additional growth on the £500k inside the trust will also be outside the estate for IHT purposes.

BUSINESS PROPERTY RELIEF (BPR)



Certain types of businesses and investments are eligible for BPR.

DOES BUSINESS PROPERTY RELIEF APPLY?

0% RELIEF

Not for profit companies
Companies being wound up
Companies that mainly deal with securities, stocks or share. Land or buildings, or in making or holding investments.

50% RELIEF

Machinery
Business property & buildings
Shares controlling more than 50% of the voting rights in a listed company.

100% RELIEF

Unlisted shares including FTSE AIM listed shares and Enterprise Investment Schemes (EIS)

This allows some or all the assets to be passed on tax-free, you can get BPR on certain types of businesses and investments.

To qualify for BPR, the deceased must have owned the qualifying assets for at least 2 out of the last 5 years before death and at the date of death.

Certain investments exist, generally a portfolio of FTSE AIM stocks, which allow you to buy into a scheme that qualifies for Business Relief. This is useful when you want to retain control over the assets purchased (in

case you need to sell at some point) but also aim to qualify for 100% relief against Inheritance Tax.

IMPORTANT:

Advice on FTSE AIM Investment's is an FCA regulated activity and as such the reader will need to take independent financial advice from a suitably qualified financial adviser, such as the author under his role as an IFA for Hoyle Capital Wealth.

These schemes allow you to benefit from Inheritance Tax relief after two years, rather than to wait for 7 years if they make a gift. These investments are typically higher risk, and you should seek independent financial advice before investing. The tax benefits on offer can be very attractive, but you need to make sure that you are comfortable with the risks.

CHANGES ANNOUNCED AT AUTUMN BUDGET 2024

Assets eligible for 100% Agricultural Property Relief (APR) and those eligible for 100% BPR will qualify for full relief up to a sum of £1 million, the excess will now receive 50% relief thereafter.

The government is proposing to make assets eligible for BPR and APR (added together) count towards the £1 million cap. The government has also announced it will reform APR and BPR relief from **6th April 2026**. At this stage it's in consultation and may not come into force.

Relief of up to 100% is currently available on qualifying business and agricultural assets. In addition to existing nil-rate bands and exemptions, the 100% rate of relief will continue for the first £1 million of combined agricultural and business property to help protect family farms and businesses, and it will be 50% thereafter.

The government will also reduce the rate of BPR available from 100% to 50% in **all** circumstances for shares designated as “not listed” on the markets of recognised stock exchanges, such as the FTSE AIM.

INVEST TAX-EFFICIENTLY



BUSINESS RELIEF INVESTMENTS

ADVANTAGES

Avoid inheritance tax after just 2 years

You own & control the assets

You can sell some or all the shares at any stage if you need access to the money (this will lose BPR and reverse the inheritance tax savings)

All potential investment growth is outside of your estate.

DISADVANTAGES

Business relief investments can be expensive

The underlying investment are risky. Unquoted companies tend to be smaller, less well known & more difficult to value.

The shares may not be diversified, which poses additional risk.

**Capital and income can value in value less liquidity, investments are not on a listed stock exchange, therefore slower to sell.
BPR could be withdrawn in a future budget.**

With careful planning and tax-efficient investing, you can effectively avoid inheritance tax altogether. These investments tend to be more complex, that's why working with an experienced financial advisor is essential.

Some types of investments buy shares in one or more privately-owned companies that qualify for business relief.

If you hold these shares for two years, their value on your death will qualify for business relief, making them exempt from inheritance tax. Examples of investments that qualify for business relief include:

Seed / Enterprise Investment Schemes (SEIS / EIS)

– Investments fall outside of inheritance tax after two years, there is an income tax relief of 50% for SEIS or 30% for EIS. Capital tax gain is deferred for 3 years allowing access to capital at any time. It's a riskier type of investment as they tend to be in smaller companies.

AIM Investments – Another method of obtaining Business Relief is through a portfolio of diversified holdings known as an AIM portfolio. It is also possible to transfer an ISA to an AIM ISA to receive the above benefits tax-free.

SPEND MORE

A bit obvious maybe but one strategy to stop your estate from getting bigger and creating a larger inheritance tax bill is to spend more.

Not only will this improve your lifestyle, but this will also help you make sure that you pay less IHT as you stop your assets from growing.

However, finding the right balance between spending today and ensuring you are secure tomorrow requires a

careful degree of planning. Your overall goal should be to ensure that you reduce your inheritance tax liability, whilst ensuring you never run out of money.

Therefore, you should be careful not to deplete your assets too quickly.

Having regular meetings with a financial advisor will help you get the right balance between enjoying today and being secure tomorrow.

UPDATE ON NEW RULES FOR PENSIONS & IHT:

Draft rules issued for IHT on pensions - 23 July 2025

The introduction of IHT on pension death benefits from April 2027 has moved a step closer with the publication of draft legislation.

There were widespread concerns that the original proposals were complex and would ultimately result in delays in winding-up estates.

To address this HMRC have shifted the burden of reporting and paying the IHT on pension death benefits from the scheme administrators to the personal representatives.

Valuing pension benefits for IHT purposes

The draft legislation also provides clarity on the value to be included within the estate. This will be the amount used to provide the death benefit and ignores any business relief.

They had been a great deal of speculation that hold business assets such as AIM portfolio could be a way of mitigating the IHT liability post 6 April 2027, but this has now been put to bed.

The New Process

HMRC have issued draft rules for bringing pension death benefits within the estate for IHT from April 2027. They have also outlined the process which personal representatives (PRs) and the pension schemes must follow.

In a change to what was originally proposed at the autumn Budget it is now the PRs rather than the scheme administrator who is responsible for reporting and paying IHT on the death benefits.

Stage 1: Pension scheme to provide valuation to PRs

The scheme administrator will have 4 weeks from the notification of death to provide the PRs with a valuation for IHT purposes.

This means that where the scheme has discretion it must confirm the split between how much of the death benefit is to be paid to a spouse or civil partner and therefore free of IHT, and how much is to be paid to non-exempt beneficiaries and potentially subject to IHT.

Stage 2: PRs value the estate

The PR will be required to collect the values of all the pension schemes the member held and aggregate these with all the other assets within the deceased's estate to determine if an IHT account is required.

Stage 3: PRs to submit IHT account

If IHT is due, the PRs must determine how much is attributable to each of the pensions within the estate and submit an account to HMRC.

They must then inform the pension beneficiaries and the scheme of the amount of the IHT due on their component of the estate.

Stage 4: Payment of death benefits

Where the death benefits are free of IHT either because the total value of the estate is below the available nil rate band or it is to be paid to a spouse or civil partner the benefits can be paid immediately without the need for probate.

Non-exempt beneficiaries will be jointly and severally liable with the PRs for the IHT due on their share of the death benefits. If the PRs haven't settled the IHT due on the pension death benefits from the free estate the beneficiary will be given two options.

They can request that the scheme administrator pays the IHT due directly to HMRC on their behalf.

They can take benefits and pay the IHT due. This will of course result in income tax if the scheme member dies after age 75. HMRC have confirmed that the amount chargeable to income tax will be reduced by the beneficiary's IHT liability.

Alternatively, the PRs can pay the IHT bill in full from other assets within the estate. If the estate beneficiary and the pension beneficiary are the same person, the pension death benefits can be paid without any deductions from the pension.

If they are not the same person, the PRs have a legal right to reclaim the IHT due on the pension death benefits from the pension beneficiary and distribute this to the estate beneficiaries. This is to ensure that the burden of IHT is spread fairly amongst all beneficiaries.

Specific points

The consultation response also provided additional clarity on several points.

Death in service

HMRC have confirmed that all death in services schemes regardless of how they are provided will not be subject to IHT. This ensures consistency between death in service benefits due from a registered scheme and those paid through an excepted group life arrangement.

Joint life annuities

Survivors benefit under a joint life annuity will not be subject to IHT. Where the continuing payments are made to a spouse these will be covered by the IHT spousal exemption. Where the payment continues to someone other than a spouse HMRC have confirmed that the survivor's rights are separate from the members rights and therefore outside the member's estate for IHT.

Trivial commutation death benefits

It's possible for individuals who receive small pensions on the death of another to commute the income for a trivial commutation lump sum, where the value of the lump sum is no more than £30,000. The intention is that these lump sums will be included when assessing IHT.

However, if the lump sum is generated from a dependant's scheme pension, then the value of the lump sum can be excluded, as the pension would have also been excluded.

Summary

Of course, these are draft rules and may be subject to change before they are enacted. However, it is now clear that the Government is committed to this path and alternative solutions for a tax on death benefit have been discounted. HMRC are expected to provide further detail on the process and mechanisms for schemes to pay IHT directly to HMRC in due course.

NEXT STEP:

Hopefully the above information has given you some insight into some of the proactive steps you can take to avoid, reduce or eradicate inheritance tax.

If you want to contact us, or are interested in receiving more details about any aspect of this guide and advice on how best to either use the details to your advantage or indeed make subtle changes to your financial plans to avoid some of the negative issues highlighted, please contact us:



01245 967118



info@portcullisretention.com



www.portcullisretention.com



Goldlay House, 114 Parkway, Chelmsford, CM2 7PR

Whilst all reasonable care has been taken in the preparation of this publication no liability is accepted under any circumstances by Portcullis Wealth Retention Ltd for any loss or damage occurring because of reliance on any statement, opinion, or any error or omission contained herein. Any statement or opinion reflects our understanding of current or proposed legislation and regulation which may change without notice. The content of this document should not be regarded as specific advice in relation to the matters addressed.



PORTCULLIS
WEALTH RETENTION LTD

Portcullis Wealth Retention Ltd is Registered in England & Wales at Companies House under reference No. 12264589. Registered Office: Bellefield House, 104 New London Road, Chelmsford, CM2 0RG.

