

£5BN+ PLANNING OPPORTUNITY FOR ADVISERS



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The amount of Inheritance Tax (IHT) being paid in the UK is increasing.

£5.4bn was paid as UK IHT during the 2020/2021 tax year.¹

According to a recent report £5.5bn in IHT receipts was collected for the 11 months from April 2021 to February 2022, a 15% (£0.7bn) increase compared to the same period in the previous year, already surpassing the amount collected in the 2020/21 tax year². This increase is, sadly, believed to be at least partly due to the higher volumes of unexpected deaths and resultant wealth transfers that have taken place during the Covid-19 pandemic, although this has yet to be verified.

The number of individual estates impacted is expected to have increased significantly from the 22,000 which were hit by an IHT charge in the tax year 2018/19 (almost 4% of total UK deaths), the last year for which data is available.

The average amount of IHT paid per estate in the tax year 2018/19 was not insignificant at £209,000, a 6% (£12,000) increase on the previous year.

Financial advisers play a key role in helping clients to protect their loved one's futures while managing their exposure to IHT but, the amount payable in IHT is on the rise. Advisers' financial planning discussions with wealthy clients have typically included tax efficient estate planning as standard, but it's evident that many people who would not generally be regarded as wealthy, are now being brought into the IHT net, mainly due to rising house prices.

SO, WHAT DOES THE HMRC DATA TELL US ABOUT THE CHARACTERISTICS OF THE PEOPLE WHOSE ESTATES ARE FUELLING THIS INCREASE IN IHT RECEIPTS?

Client target market profiles

Analysis of the relevant HMRC data shows that there are two principal groups of people whose estates end up with an IHT bill. For advisers, it's perhaps helpful to think of them being two distinct client target market segments, each with their own characteristics.

Older and Wealthier Clients

Estates valued at over £1m or more accounted for 81% (£3.7bn) of total IHT tax liabilities but represented only 4.3% of all estates (tax year 2018/19). This can be viewed as the traditional IHT advice group, but the HMRC data provides some more granular detail to suggest that female-owned estates tend to have higher IHT charges than those owned by males. This is likely to be due to the fact that females tend to have a higher life expectancy and a higher probability of living longer than their spouse which often results in them leaving an estate on which spousal relief cannot be claimed.

The majority of this group's estate value is made up of securities and UK residential buildings. Estates are also more likely to consist of unlisted securities and other assets, which attract specific reliefs like agricultural and business property relief (see below). This is because, as the age of the person increases, so does their tendency to hold assets in cash and securities, as more of their accumulated wealth is no longer tied up in property. For instance, those aged 85 and over hold around 35% of their wealth in securities and around a third in UK residential property.

Younger Property Owners

By total number, estates valued at less than £1m accounted for around 96% of all IHT-paying estates in tax year 2018/19. Estates valued at this level accounted for £1bn (19%) of total IHT receipts, representing a significant

amount of money not being passed onto loved ones, although a relatively low proportion of the £71.2bn in total gross assets owned by this group, of which £41.6bn was held in UK residential buildings and £18.6bn in cash.

Where net estate value is less than £1 million, estates are likely to consist mainly of residential property and cash. Around half of the value of taxpaying estates held by those aged under 65 at death is made up of their main UK residence. People aged 45 to 64 held around 18% of their wealth in securities.

There is no doubt that where people live also has a significant bearing on exposure to IHT, principally due to varying residential property prices. Unsurprisingly London and the South-East has the highest numbers of estates facing an IHT charge, accounting for 46% of the total IHT charged across the UK in the tax year 2018/2019.

The average IHT-paying estate in London paid £271,800 compared with £152,900 in the North-West of England, for example.

SO WHY IS MORE IHT BEING PAID?

There are two principal reasons why IHT receipts are increasing:

1. An erosion of the real value of the Nil Rate Band (NRB) as this threshold has been frozen at £325,000 since April 2009. By the time this is potentially changed in April 2026 it will have been frozen for 17 years; and
2. Significant increases in asset valuations since the financial crisis, including securities and property.

To a certain extent this is counter-balanced by a reduction in deaths incurring an IHT charge following the introduction of:

- a. the Transferable Nil-Rate Band (TNRB) in the tax year 2008/09, where any unused NRB could be transferred to a surviving spouse or civil partner. This is the largest exemption set against assets, with around 40% of estates above the NRB taking advantage of this exemption in 2018/19, accounting for around

70% of the total value of reliefs set against assets; and

accounting for around 70% of the total value of reliefs set against assets;

- b. the introduction of the Residence Nil-Rate Band (RNRB) tax-free threshold from April 2017 when a residence is passed on death to a direct descendant. Introduced in 2017/18 at £100,000 and now fixed at £175,000 until April 2026. As with the TNRB, any unused amount can be transferred to a spouse or civil partner meaning that some couples have an effective RNRB threshold of £350,000.

19,100 estates were able to use the RNRB threshold to shelter £3.6bn of chargeable estate value from an IHT charge in the tax year 2018/19 alone.

IHT liabilities can also be mitigated by Agricultural Property Relief (APR) and Business Property Relief (BPR) for those estates that are eligible.

However, despite these reliefs, growth in the value of the assets combined with the freezing of thresholds is increasing the number of estates on which IHT is payable. This emphasises the importance of advisers being proactive in addressing potential future IHT issues when discussing financial planning with clients of all ages.

WHAT CAN ADVISERS DO TO HELP?

Financial advisers play a key role in helping their clients mitigate IHT and their advice can be very effective in minimising the impact of tax as they pass assets onto their loved ones. It is clear from HMRC's published data that advisers need to consider the likely IHT exposure of a wide range of clients, including younger clients who are home owners.

The starting point, as always, is to encourage clients to make a will recording their wishes at the time, and to keep this up to date, to ensure that there are no unintended consequences on their death.

Advisers can then discuss with their clients how they are likely to be able to benefit from the use of exemptions and reliefs available, principally the NRB, TNRB and RNRB, but also APR and BPR where relevant.

For those clients who are still likely to face an IHT liability after these exemptions and reliefs, putting money and assets into a trust can help pass wealth to their loved ones in the quickest, most tax-efficient way.

Advisers can also discuss the opportunity for the client to make gifts to a trust or outright gifts, reducing the value of their estate when they survive for a further seven years.

A trust structured with an offshore bond can allow assets to be passed down the generations whilst being held securely in a robust structure within a tax-deferred environment, which can be managed in line with the client's changing risk profile. Advisers can help to put this type of arrangement in place on a bespoke basis or can utilise a tried and tested 'packaged' solution such as Utmost Wealth Solutions' Estate Planning Bond or Generation Planning Bond.

Interestingly, Utmost offer the ability to convert our capital redemption bonds into a discounted gift scheme, in whole or in part at any time to adapt to a client's changing circumstances, the only company to offer such a facility.

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Another important consideration for advisers is whether or not a client would wish to support their favourite charities on their death, on a tax-efficient basis. Transfers to qualifying charities form the second largest exemption from IHT with transfers of £1.7bn from 10,100 estates in the tax year 2018/19. Where at least 10% of the value of the client's estate (after deductions for liabilities, reliefs and

other exemptions) is left to qualifying charities, the estate benefits from a reduced 36% IHT rate.

Once all reliefs, exemptions and gifting have been maximised and it is likely that there will be a remaining IHT bill due on second death, advisers' financial planning could consider insuring the life of the client for the likely amount of tax due on death, potentially with the insurance premiums to be paid by the beneficiaries to avoid the 'gift with reservation' rules.

Of course, for advisers to maximise the benefits to their clients of their overall financial planning, and mitigate potential IHT exposures specifically, they need to have a full 360-degree view of the client's financial, family and lifestyle situation. Advisers increasing tendency to manage their clients' range of different assets and product wrappers 'on-platform' can be both a strength and weakness in this respect. On the positive side, advisers are likely to be more aware of any potential IHT exposure as they have a better view of the client's total wealth if all wrappers are on the chosen platform where they can also use the pensions, offshore bonds etc. and trusts available. On the other hand, the more investment-oriented and transactional nature of the platform proposition may diminish a focus on tax planning.

In conclusion, it is difficult to over-emphasise the importance of the adviser's role in looking after their clients' best interests beyond important short-term considerations such as investment returns over the next five years. Helping clients to pass on wealth to future generations is surely one of the most important and rewarding aspects of an adviser's role. Younger property owners now represent an additional group to the traditional older and wealthy, whose exposure is only likely to increase if they are not brought inside the IHT advice process.



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Source

¹ National Statistics www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary#use-of-exemptions-and-reliefs

² National Statistics www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk/hmrc-tax-receipts-and-national-insurance-contributions-for-the-uk-new-monthly-bulletin

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