Let's talk about Inheritance Tax

Further opportunities to mitigate Inheritance Tax ('IHT')

As we have seen in the previous two articles, Inheritance Tax may be avoided or its effects at least mitigated, by using the allowances available and also by the use of trusts.

There are other opportunities available to help reduce the impact of IHT and this final article in the series will explore some of these options.

Charity Gifting

Many people will make gifts to charity through their wills. Gifts to charity are exempt from IHT, so leaving a gift of any size to charity will not count towards the total taxable value of the deceased's estate.

Furthermore, if the gift is 10% or more of the net estate, (i.e. the total estate value less the nil rate band of £325,000) then the rate of IHT that applies to the remaining estate reduces from 40% to 36%.

Consider Other Investments

Another option is to consider investing in a portfolio of selected shares on the Alternative Investment Market ('AIM').

Such a portfolio will become IHT free after two years of holding them, as such shares should qualify for Business Relief for Inheritance Tax.

What is Business Relief?

Business Relief is a way of giving people an incentive to invest in trading businesses. It was introduced by the UK Government back in 1976. It is a valuable IHT relief which can reduce the value of 'relevant business property', which includes certain assets and business interests.

The relief can be 100% or 50% when it is granted.

The value of any 'excepted assets' is excluded, however. These are assets used mainly for the private benefit of the business owner or their family.

What's important to know about Business Relief?

First of all, not all companies will qualify for business relief. In order for the relief to apply a key requirement is that the company must be trading. So, a company can't just hold a rental property or cash for instance. Similarly, a company can't hold other assets that are considered to be investments.

In order to qualify for relief, a company must be trading, in the sense that it is carrying out activities with the intention of making a profit.

Let's talk about Inheritance Tax

How is Business Relief granted?

The qualification of an investment for Business Relief is considered by HMRC on a case-by-case basis.

Once HMRC has carried out its assessment, investments that qualify for Business Relief can be passed to beneficiaries free of inheritance tax.

To obtain business relief the executors of the estate must complete a specific form and submit to HMRC.

Of course, the two-year holding criteria must also be met in order to obtain relief.

Sounds a bit risky?

Investing in companies listed on the Alternative Investment Market can be a risky business. There are however some well-known names listed on AIM such as Hotel Chocolat, Fevertree Drinks and Naked Wines.

As there are 728* companies listed on AIM, it certainly pays to seek professional advice before investing. There are a number of specialist investment managers whose expertise lies in screening the AIM market for sound investment opportunities.

For those happy to take more investment risk, there is another option which also can qualify for Business Relief if held for two years or more.

OK tell me more…

Further tax reliefs are available through investing into small unquoted UK companies. Again, HMRC grant this tax relief to encourage investment into these entrepreneurial businesses.

The trade-off for tax relief is that there is a greater chance of these businesses failing.

For those prepared to accept the risk of potential losses, investment into Enterprise Investment Schemes ('EIS') provide relief from IHT using Business Relief as discussed above.

Enterprise Investment Schemes (EIS)

As we have seen the tax relief available for EIS is designed to encourage investment into higher risk start up or younger companies. To award the investor for this increased risk, the tax reliefs on offer are:

- Income tax relief of 30% of the investment
- Capital Gains exemptions on any profit on the investment, if held for a minimum of 3 years
- Loss relief should the company fail
- Capital Gains tax deferral

And for more importantly for the purposes of this article, Inheritance tax exemption if held for the minimum two-year period.

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Now that does sound risky, who would invest in these?

It is risky. There is no typical investor but those who wish to help small start-up companies tend to invest. They like to follow the company's fortunes and get a sense of enjoyment by helping these start-ups, as well as benefitting from the tax reliefs.

These start-ups can be in all different sectors, from food and drink to renewable energy, robotics, pest control, early stage drug discovery and semi-conductor design.

Again, it pays to seek professional advice before considering such investments.

So lots of options to avoid Inheritance Tax, which is best?

There certainly are lots of options and each solution is as unique as the individual.

We saw at the start of this series that inheritance tax can be mitigated and even avoided and yet HMRC brought in over £5.4bn in Inheritance Tax revenues in the tax year 2018/19. Perhaps this is down to reluctance to discuss sensitive matters with family members, or unease at considering and planning for our own mortality?

The final option of course is to do nothing as many individuals do, leaving HMRC as the likely beneficiary.

The key to avoid this outcome is to start planning and to have these discussions early, engage with experienced and qualified professionals who can help you to negotiate the options available.

**source: FTSE AIM (London Stock Exchange, September 2020)*