WISE
INVESTOR



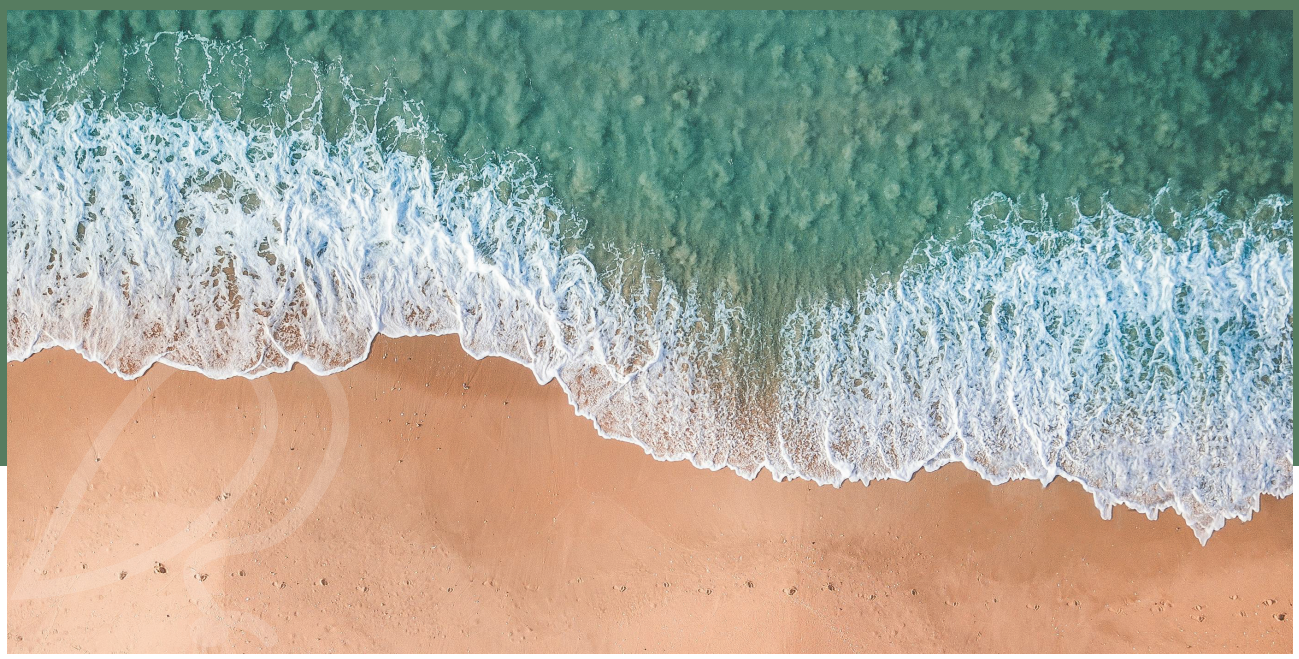
HOW TO BEAT THE INHERITANCE TAX TRAP

IMPORTANT NOTE

This guide, like the service Wise Investor offers, is for UK-domiciled sophisticated and high net worth investors.

It is not advice or a personal recommendation. This is a quick summary of a complex subject and does not cover every nuance. You should not make – or refrain from making – any decision based solely on the content of this guide. If you are unsure an investment is right for you, please seek professional advice. We have made every attempt to ensure the information in this guide is correct and accurate (April 2025), but cannot guarantee it.

PLEASE REMEMBER, TAX BENEFITS DEPEND ON CIRCUMSTANCES. TAX RULES CAN CHANGE.
IF IN DOUBT, PLEASE SEEK SPECIALIST TAX ADVICE.



The 'Most Hated' Tax Of All

Inheritance tax (IHT) is regularly described as the most unjust and hated of all taxes. After all, if you have already paid tax during your lifetime, why should anything you leave behind be taxed again – and at a whopping 40%? It is a tax on money that has already been taxed.

From April 2023 to February 2025, HMRC collected £6.8 billion in inheritance tax. It is now forecast this will reach £9.7 billion by 2028/29, the result of frozen IHT allowances and inflation pushing the value of bequeathed property values higher.

So what could you do to prevent the taxman from taking a large share of the assets you have put by for your loved ones?

It is simpler than many think to mitigate – even completely eliminate – any IHT liabilities your estate may have, using government-sponsored schemes.

Before you read any further, you may like a quick reminder of how IHT currently works. The sums involved may be very substantial, so it merits close attention.

Please remember though, IHT planning is a complex subject. How it will affect you and which course of action is best will depend on your circumstances and, furthermore, tax rules can change. If you are in any doubt, you should seek specialist advice.

What IHT is – and how it works

IHT refers to inheritance tax. If your estate exceeds a certain amount when you die – currently £325,000 plus an additional allowance of up to £175,000 for your home – it is likely to attract IHT at a flat rate of 40%. The £325,000 threshold is known as the nil-rate band, the amount up to which a rate of 'nil' tax is charged. It was set at the current level in 2009 and has now been frozen until 2028. The additional allowance is the residence nil-rate band (we explain more overleaf).

Your estate is the total value of all the assets to which you're beneficially entitled (e.g. property, savings, investments, etc.) less any liabilities (e.g. loans, credit cards, mortgage). It's important to note your pension or drawdown plan are not included; they normally sit outside your estate at death for IHT purposes.

The excess could be subject to a tax charge of 40%. This could decrease to 36% if you leave at least 10% of the net estate to a Registered Charity.

Married couples and civil partners are allowed a tax break. When one dies, the whole or part of their estate can be passed on to the other completely tax free. If all of the assets of one are left to the other, none of the first spouse's or civil partner's nil-rate band is used.

So when that partner in turn dies, they can add their deceased spouse's or civil partner's unused nil-rate band allowance to theirs, and potentially pass on up to £650,000 tax free. However, this does not apply if you are an unmarried couple. Below are some examples.

Example 1 – Single person, no children		
Total value of all assets	£1,250,000	–
Total liabilities	£30,000	=
Estate	**£1,220,000**	–
IHT nil-rate band	£325,000	=
Chargeable estate	£895,000	x
IHT	40%	=
Tax payable	**£358,000**	

Example 2 – Widow/widower or surviving civil partner, no children		
Total value of all assets	£1,250,000	–
Total liabilities	£30,000	=
Estate	**£1,220,000**	–
Own IHT nil-rate band	£325,000	–
Spouse/civil partner's IHT nil-rate band	£325,000	=
Chargeable estate	£570,000	x
IHT	40%	=
Tax payable	**£228,000**	

Both examples assume the current nil-rate band of £325,000. Example 2 assumes the deceased didn't use any of their allowance, i.e. their whole estate was passed on tax free to their spouse or civil partner on their death.

What is the residence nil-rate band?

The 'residence nil-rate band', which became available in 2017, is an additional nil-rate band which applies to an individual's residential property. It is £175,000 for the current tax year and will remain at this level until 2028.

This means that currently a single person could have a total IHT-free allowance of £500,000 (£325,000 nil-rate band, plus £175,000 residence nil-rate band). This could double to £1 million for married couples and civil partners.

The band is transferable, which means it is possible to benefit from a deceased spouse's or civil partner's unused residence nil-rate band.

But there are a few details of which to be aware.

Firstly, the residence nil-rate band only applies to one property which has been at some point your 'residence', provided you owned it on or after 8 July 2015. A property that has never been your residence does not qualify.

Secondly, if more than one of your properties was at some point your main residence, you can only use the allowance against one; your personal representatives can nominate a property. If you don't own a residential property, this allowance can't be used.

Thirdly, the allowance only applies if you pass a residence, or the proceeds from selling it, to 'direct descendants': your children (including step-children and adopted children) and their children. It does not apply if you bequeath your home to nephews, nieces, your parents, siblings or cousins.

And lastly, the residence nil-rate band will be tapered for estates worth more than £2 million. 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 if your estate's net value is £2,350,000 or more, your residence nil-rate band should be zero; your estate will not qualify for this additional allowance and is likely to attract 40% IHT on any value in excess of the basic nil-rate band allowance (see examples and chart overleaf).

So, suppose you find the nil-rate bands still leave your estate exposed to IHT. What could you do to save your loved ones from having a large slice of your bequest taken away by the taxman?

There are a number of options, and you might want to consider using a combination of them.

In this guide we explain four of the most common.

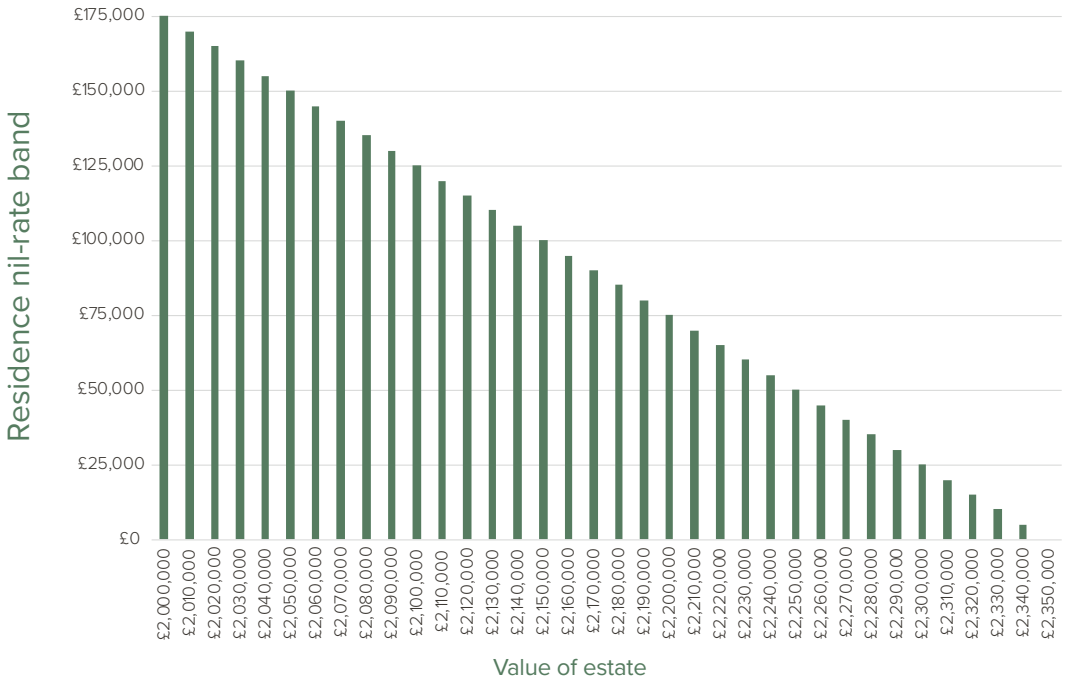
Remember, IHT planning can be complex: if you are unsure please seek expert advice.

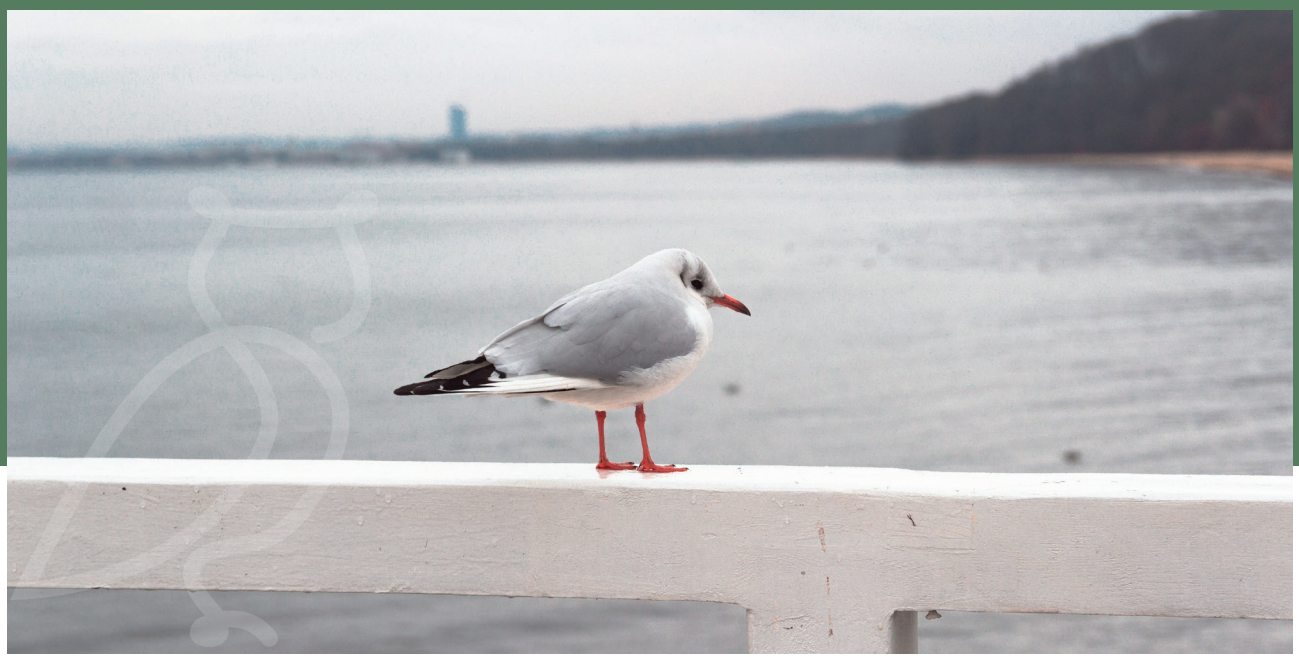
Example 3 – Single person with children and/or grandchildren		
Total value of all assets (excl. main residence)	£350,000	+
Main residence	£900,000	–
Total liabilities	£30,000	=
Estate	**£1,220,000**	–
IHT nil-rate band	£325,000	+
Residence nil-rate band	£175,000	=
Total IHT free	**£500,000**	
Chargeable estate	£720,000	x
IHT	40%	=
Tax payable	**£288,000**	

Example 4 – Widow/widower or surviving civil partner with children and/or grandchildren		
Total value of all assets (excl. main residence)	£350,000	+
Main residence	£900,000	–
Total liabilities	£30,000	=
Estate	**£1,220,000**	–
Own IHT nil-rate band	£325,000	+
Spouse/civil partner's IHT nil-rate band	£325,000	+
Own residence nil-rate band	£175,000	+
Spouse/civil partner's residence nil-rate band	£175,000	=
Total IHT free	**£1,000,000**	
Chargeable estate	£220,000	x
IHT	40%	=
Tax payable	**£88,000**	

Again, these examples assume the current nil-rate band of £325,000 and that the first of the couple to die didn't use any of their allowance, i.e. their whole estate was passed on tax free to their spouse or civil partner.

How does the residence nil-rate band taper work for a single person?





Have You Made A Will?

Making a will is the most basic – but surprisingly often neglected – form of estate planning. Indeed, more than half UK adults do not have one.

The lack of a will can add strain and distress to the surviving family at arguably the worst time. But that's by no means the only consequence of 'dying intestate', i.e. without a will.

Unless your estate or family setup is very simple, it is important to make a will, revise it regularly and keep it up to date.

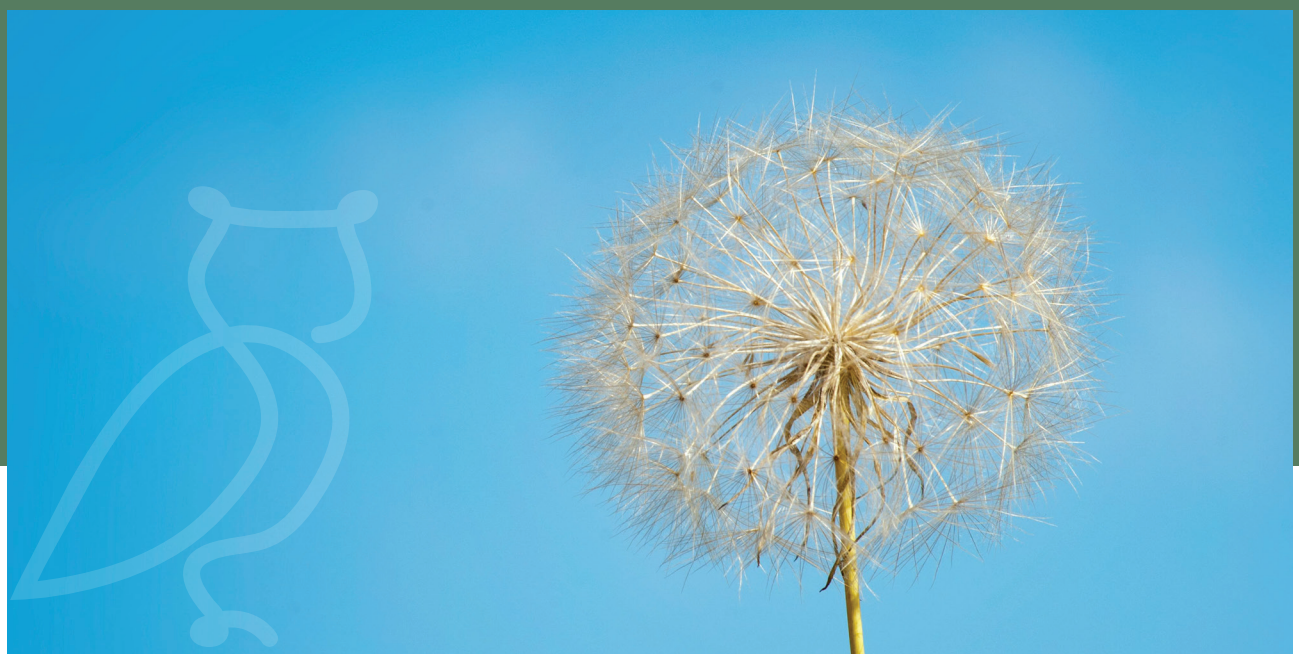
What happens if you do die intestate? No matter what your wishes may have been, your estate will be distributed according to set rules. This means a larger portion of your estate may go to the taxman.

- If you are married or in a civil partnership and have no children, your estate will go wholly to your surviving spouse or civil partner. The estate will be passed on free from IHT.

- If you are married or in a civil partnership and do have children, the surviving married partner will take the first £270,000 and then be fully entitled to half of the rest. Children will share half of anything above £270,000 but will have to wait until they're older than 18. The amount that goes to your spouse or civil partner will be IHT free. The amount that goes to your children will use your nil-rate band, and, if greater than £325,000, could be subject to IHT.

- If you are single, your entire estate – minus any IHT payable – goes to surviving blood relatives in a set order. Children come first, followed by parents, siblings, nieces and nephews. In the absence of any blood relatives your estate goes to the Crown.

It's important to note that unmarried couples are treated as single. If one of you dies without a will, the other is entitled to nothing.



Should You Make Gifts?

Giving your assets away during your lifetime may be a simple way to cut the potential IHT bill to which your estate could be subject on death.

Some gifts are usually free from IHT (such as under the annual and small gift exemptions). Others (Potentially Exempt Transfers or PETs) only become completely free from IHT after seven years. So if you die before the seven years are up, IHT might be due, albeit potentially at a lower rate than 40% (see 'taper relief' below).

Tax-free gifts

You can give unlimited amounts tax free to your spouse or civil partner, provided you're both domiciled in the UK. Your gift will be immediately outside your estate, but will become part of theirs.

You have an annual £3,000 tax-free gift allowance, known as the annual exemption. If you haven't used your annual exemption fully in the previous year, you can combine it with your current year's allowance.

You can also make unlimited tax-free small gifts (up to £250 per recipient each year). However, you cannot use your annual exemption and your small gift exemption for the same person in the same year.

In addition, you can give immediately IHT free:

- Donations to recognised charities, national museums, universities, political parties and some other institutions
- Any part of your income you regularly give away, provided you can demonstrate this does not affect your standard of living
- Wedding gifts: up to £5,000 to your child; up to £2,500 to your grandchild; up to £2,500 to your spouse or civil partner to be; £1,000 to anyone else
- Maintenance gifts: to a current or former spouse or civil partner, an infirm dependant or children in education.

Gifts that may be tax free

Most gifts you make during your lifetime, except those above, are 'potentially exempt transfers': they are completely IHT free if you survive seven years after the gift. If you die within seven years, the total value of the gifts

will be included in your estate and use up part or all of the nil-rate band.

If the value of those gifts exceeds the nil-rate band, your estate may have to pay IHT at the full rate or at a discounted rate, known as 'taper relief', depending on when you died.

How does taper relief work?

Number of years between gift and death	Proportion of 40% IHT payable
0-3	100%
3-4	80%
4-5	60%
5-6	40%
6-7	20%
7+	nil

What are the drawbacks?

At first sight there are no drawbacks other than the obvious: you lose control of that asset. So you need to consider how much you can afford to give.

You should also consider that, for gifts to become completely IHT free, you need to live for at least another seven years. If you like the idea of giving assets or money to your loved ones during your lifetime, using your annual and small gift exemptions might be sensible. It is also simple and straightforward and you can make sure each recipient receives exactly the amount you intend.

Nobody knows when they're going to die, and seven years is a long time. Some might feel giving up their wealth during their lifetime, with no certainty this will be effective for estate planning, makes larger gifts less attractive.

Another reason why many don't like to give away large sums is concern over what the recipient might do with the gift or what might happen to the gift should the recipient's circumstances change.



Set Up A Trust

Trusts have been around since the time of the Crusades when lords and knights wanted to keep their castles out of the hands of the taxman or crooked relatives while they were fighting in the Holy Land.

There are different types of trust. Finding the arrangement that can achieve what you want and ensuring it is drafted appropriately usually requires professional legal and tax advice. Here we provide just a brief overview of the main types most commonly used for estate planning.

Discretionary trusts are a type of trust commonly used to manage assets (money, investments, land or buildings). The trustees (you could be a trustee yourself) make the decisions about how to use the trust income and/or capital, but cannot personally benefit from either.

Assets put (settled) into a discretionary trust usually fall outside the settlor's estate seven years after settlement. So, if you die within seven years of settling assets, IHT may still be payable by the estate – similar to the position if you had made a potentially exempt transfer.

You decide at the start who the beneficiaries are and who should receive how much and when.

The flipside of this flexibility is that gifts to a discretionary trust are treated as "chargeable lifetime transfers". This means that 20% IHT is immediately payable on anything put in trust in excess of the current £325,000 nil-rate band. In general, up to £325,000 can be put into a discretionary trust every seven years without incurring the immediate IHT charge.

If the settlor dies within seven years, IHT will then be reassessed at the higher rate of 40%.

Discretionary trusts may also be subject to 10-yearly periodic charges and proportionate exit charges. These charges are complicated and you should seek further technical advice if you believe such a trust would be beneficial.

Immediate Post Death Interest Trusts are typically set up on the death of one spouse and provide an income for the life of the other, with ultimate ownership of the trust

assets passing to another beneficiary (often children) when the second spouse dies. The assets in these trusts remain within the second spouse's estate for IHT purposes.

A **Discounted Gift Trust** (DGT) is a type of trust usually set up in connection with an investment (e.g. a bond). The settlor gifts a lump sum into the trust but can retain a lifelong 'income' from that money (the total value of all the income is the 'discount' which should be immediately outside the estate). Any money that comes back returns to the estate; so, if not spent, it will start to increase the amount on which IHT is payable again. The remainder will be treated like any other gift into a trust.

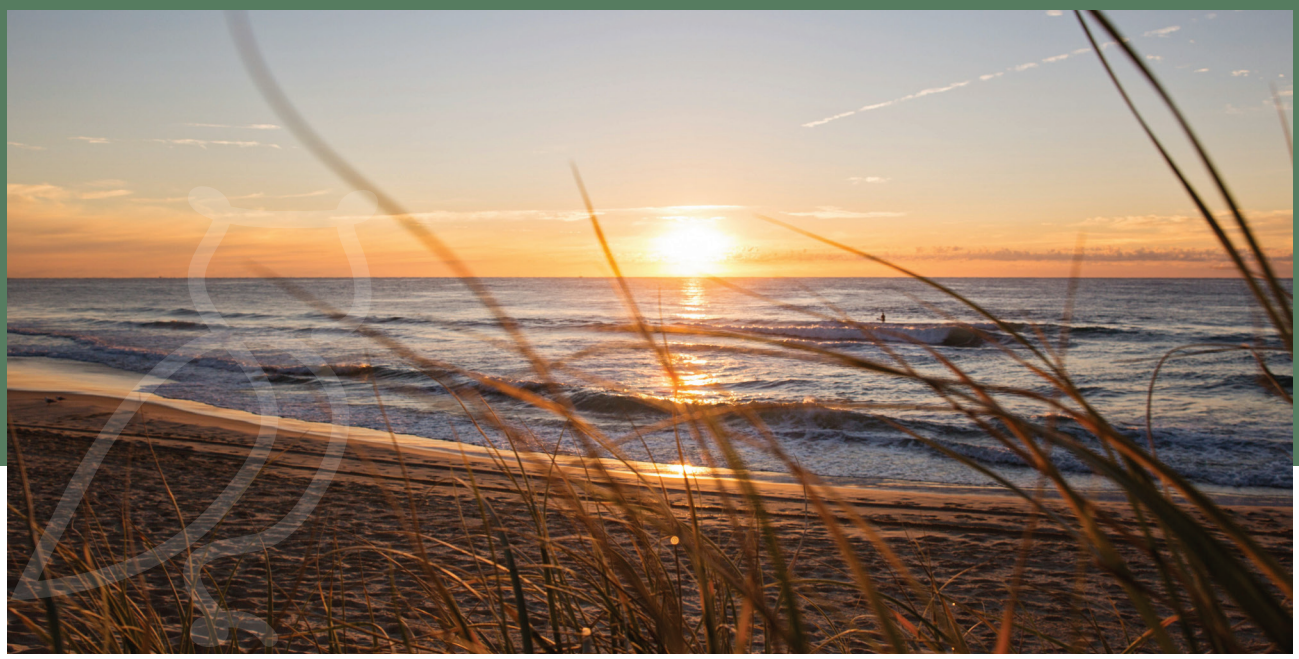
What are the drawbacks?

Trusts are traditionally a staple of estate planning. They can be very effective at reducing the value of your estate and therefore the potential IHT charge.

On the flipside, the relevant tax and general laws are complex. In addition, a trust might have similar obligations to those of a company: annual accounts and tax returns may be required and tax may be payable. So the settlor will typically take specialist advice when establishing a trust and the trustees may well take legal, accountancy and investment advice as and when required.

Some investors may not like the idea of trusts because, as with gifts, once in a trust, assets are no longer in their control. And, of course, as with some gifts, assets placed in trust will only fall completely outside of your estate for IHT purposes if you live for at least seven years after establishing the trust.

As you will have gathered, the subject of trusts is complex and trust rules are often subject to change. Moreover, any decision you make may be irreversible. So it really is sensible to seek professional advice before you go ahead.



Investing In Companies Qualifying For Business Property Relief (BPR)

Investing in companies that qualify for Business Property Relief (BPR) is a flexible alternative that could help you pass more of your wealth to your loved ones, although it has its own significant investment risks.

BPR was first introduced in 1976 to allow family businesses to be passed down through generations, free of IHT.

Its scope subsequently widened and in 1996 became available for a range of assets, including some private or AIM-quoted companies. This has opened up an opportunity for investors.

If you own shares – no matter how many – in a company that qualifies for BPR, those shares could be potentially passed on free from IHT as long as you have owned them for at least two years and still hold them on death. No IHT should be payable by your estate on such an investment.

Generally, there are no complex legal structures or trusts to set up.

Moreover – unlike the case with making lifetime gifts or settling assets into trust – the investment is simply held in your name. So if your circumstances change, you could sell down some or all of your investment, though this may take some time and the money you withdraw is no longer shielded from IHT.

Please note that this is not a tax-planning tool, it is a type of investment that offers a tax benefit.

As with all investments, the value can fall as well as rise, so you could get back less than you invest – potentially you could even lose everything invested.

That said, the combination of speed, simplicity and ability to plan during your lifetime without giving up control makes this an increasingly popular option for some experienced investors happy to accept the risks.

Which companies qualify for BPR?

BPR-qualifying companies can be private businesses, or may be quoted on junior stock markets, such as AIM. However, not all private or AIM-quoted companies qualify for relief.

They must also be a qualifying 'trading' company. This excludes companies that mainly deal with securities, stocks or shares, land or buildings, or in the making or holding of

investments. It also excludes not-for-profit organisations and companies that are being sold or are in the process of being wound up (except in specific circumstances).

Provided a company qualifies in full for BPR, under current rules an investment in its shares should benefit from 100% IHT relief if you have held them for at least two years and you still hold them on death.

How can you invest in BPR-qualifying companies?

One route is to invest directly, by acquiring shares in BPR-qualifying companies. This can be daunting for many investors without the resources or time to find and properly assess the qualifying conditions.

Don't forget, your investment is linked to the fortunes of the underlying company. The capital invested is not guaranteed: the value of your investment can fall as well as rise; you could even lose the whole amount you invest. Professional asset managers can help investors navigate this risky area.

In the case of an AIM-quoted portfolio, a good investment manager should select the portfolio companies, conduct research, legal and financial due diligence, assess risks and ensure rigorous control and monitoring. In the case of an unquoted portfolio, the manager can establish and manages the portfolio companies to ensure they qualify for BPR as well as meet other investment objectives.

You could also benefit from some diversification. AIM portfolios typically invest in 20-35 companies; unquoted portfolios may have fewer holdings.

Once you invest, you will probably expect to own those shares for as long as you live. After two years from the date of the investment, the portfolio could be passed on free from IHT on your death. If your beneficiaries sell the shares, any amount raised would become part of their estate.

Should you die before the two years have passed, the portfolio can, as with any assets, be passed on to your spouse or civil partner tax free, without having to restart the two-year BPR clock. If they choose to continue to hold the portfolio, provided the combined holding period between both exceeds two years, the shares can be left free from IHT upon their death.

You can find a selection of portfolios currently expected to qualify for BPR on the www.wise-investor.com

What are the drawbacks?

BPR portfolios are investments in shares. To qualify for BPR, the company or companies invested in cannot be listed on a main stock exchange, such as the London Stock Exchange (LSE).

EIS and SEIS investments should be IHT free after two years

Investors who are not exclusively interested in IHT mitigation might consider investments that qualify for the Enterprise Investment Scheme (EIS) or the Seed Enterprise Investment Scheme (SEIS).

Such companies are typically not managed with IHT relief as a priority, however do generally qualify for BPR and therefore offer IHT benefits, in addition to income tax relief and capital gains reliefs.

EIS investors could currently receive up to 30% income tax relief and defer unlimited capital gains – potentially indefinitely, provided they made the gain up to three years before or one year after the EIS investment. They can also shield their investment from IHT after holding it for two years.

SEIS investors could currently receive up to 50% income tax relief, halve any capital gains tax due and also shield their investment from IHT after two years.

EIS and SEIS often invest in much smaller companies than IHT portfolios, so the risks can be even greater. In addition, by their nature EIS and SEIS are illiquid and the tax benefits depend on the companies retaining their qualifying status. Tax rules can change and the value of benefits depends on circumstances.

Find out more information about benefits and risks of EIS and SEIS at www.wise-investor.com to help you decide for yourself if these might be worth considering.

Many of those selected within AIM portfolios may be well known and established businesses. However, these companies are subject to less stringent checks and regulations compared to a business listed on the main stock exchange. They can in other cases be newer, smaller and more volatile. Inevitably, this carries extra risks.

The portfolio manager will typically focus on established, profitable and cash-generative companies. This, alongside diversification and due diligence, could help but won't remove risks completely. Your investment can still go down as well as up and you may not get back what you invested: you may even lose your capital.

Tax rules can change and the availability of BPR will require portfolio companies to maintain their qualifying status – should they lose it, IHT relief would be lost too.

BPR is assessed at death: there is no definitive list of firms which qualify for the relief.

You retain control of your assets and can access them if need be. However, AIM and unquoted shares are typically less liquid than those listed on a main stock exchange, so it will normally take longer to liquidate your portfolio.

Lastly, shares that qualify for BPR can benefit from IHT relief, but, unlike trusts and gifts, still form part of your estate. This could affect how much of the residence nil-rate band your estate could benefit from – if at all.



How Might You Leave Your ISAs Free From IHT?

There is £741.6 billion held in adult ISAs, according to the latest figures (2021/22). Did you know some of that money might still be subject to tax?

That's because ISAs are normally free from income and capital gains tax, but not from inheritance tax. So, on your death (or your spouse's or civil partner's death if later) your fund could be subject to a tax charge of up to 40%.

Rules are slightly more favourable for married couples and civil partners. When you die, your spouse or civil partner receives a one-off additional allowance for the value of your ISA, so they can transfer it to their ISA and keep sheltering those assets from income and capital gains tax. Upon their death, however, the ISA would be part of their estate and potentially subject to IHT. In other words, the potential liability does not go away, but is only deferred.

There is a potential solution for experienced investors

Since 2013, you are allowed to hold AIM shares in a Stocks & Shares ISA. This could be of interest to investors with sizeable ISA assets they wish to pass on, without the burden of an IHT bill, to their loved ones.

How so? Because companies quoted on AIM can qualify for BPR, you could transfer part or the whole of your ISA into an ISA portfolio that invests in AIM shares and is managed by an asset manager who selects BPR-qualifying companies.

To give you an idea of the impact this could have on your IHT liability, let's compare two scenarios: a £100,000 Stocks & Shares ISA portfolio and a £100,000 AIM IHT ISA portfolio. With an AIM IHT ISA an investor could pass on an extra £37,303 IHT free.

An AIM IHT ISA is similar to the IHT portfolios described on the preceding pages of this guide, with very similar benefits and risks. It invests in 20 to 35 companies and often targets growth. The difference is, unquoted companies cannot be held within a Stocks and Shares ISA, whereas AIM-quoted companies can.

You can make new ISA investments each year into such a portfolio, subject to the current ISA allowance (£20,000) or transfer existing ISAs (unlimited amounts). As your money would still be in the ISA regime, besides shielding

your money from IHT, you would also benefit from tax-free growth and no further tax on income.

Please remember though, an AIM IHT ISA portfolio may be more risky, more volatile and less diversified than a conventional, well-diversified Stocks & Shares ISA portfolio.

You can find a selection of AIM ISA portfolios on the www.wise-investor.com.

What are the drawbacks?

As with IHT portfolios, you are investing in companies subject to less stringent checks and regulations compared to a listed business. They can also be newer and smaller businesses – making them more volatile and also more prone to failure.

Tax rules can change and the availability of tax relief depends on portfolio companies maintaining their BPR-qualifying status – should they lose it, IHT relief would be lost too. There have been, and continue to be, widely reported rumours that the government might change IHT rules and reliefs in future (after any election).

Like any ISA, you can access your assets if need be. However, because AIM shares are much less liquid than those listed on the main London Stock Exchange, it will usually take longer to liquidate your portfolio.


WISE
INVESTOR