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5 Common IHT Mistakes and How to Avoid Them

In the past, IHT planning was a niche area, only required for high-net-worth families. Given the rise in property values and the static nil rate band, IHT is now affecting more families with modest wealth. IHT planning is now firmly in the mainstream and should be considered along with your investment, pension, and protection requirements.

Unlike many other forms of tax, you have a lifetime to exercise some control over your IHT liability. You might not be able to wipe it out altogether, but with careful planning, you can reduce taxes and ensure that more of your estate goes to your loved ones.

In this guide, we look at five common IHT planning mistakes and offer some tips to avoid them.

Not Making a Will

Making your will does not directly reduce your IHT liability, but it is a key component of your estate plan and should not be overlooked. Many people put off making a will, particularly if they believe their estate is relatively simple, or if they are having trouble making key decisions.

If you die without a will, this is known as intestacy. In this scenario, the court would appoint someone to deal with your estate – this may not be the person you would choose. Assets are distributed in a strict order, with spouses and children taking priority. If you are unmarried with no children, your estate would pass to other family members. If you don't have any living relatives, your estate passes to the Crown.

The rules are inflexible and don't account for unmarried partners, step-children or close friends. They also don't take family relationships or the beneficiaries' circumstances into account.

Depending on your situation, it may be more efficient to pass your assets to your spouse to make use of your combined nil rate bands. Alternatively, it may be preferable to use your own nil-rate band by passing assets to other individuals or into a trust. This can help to reduce IHT on second death, and means that your nil rate band is not wasted if your spouse remarries.

Writing a will is simple and inexpensive, and it gives you control over your estate. Even if it does not immediately reduce your IHT liability, it is an important part of your plan.

Not Making Use of Gifting Allowances

You can give away up to £3,000 per tax year, which is immediately outside your estate. If you don't use this allowance, you can carry it forward by up to one tax year. Married couples could therefore gift up to £12,000 this tax year for an immediate reduction in their estate. There are also limited exemptions for weddings, birthdays, and other special occasions.

If you have a regular income from employment, property rental or share dividends, you can also make regular gifts from surplus income. The main conditions are that the gifts come from income rather than capital and that they follow a regular pattern. It could be worth considering this while you are still working, rather than waiting until you retire, when you might be more dependent on your capital to support your lifestyle.

Any gifts which do not qualify for exemptions will drop out of your estate after seven years. This means that if you die during this qualifying period, the gift will be added back into your estate and potentially incur IHT.

Lifetime gifts can reduce the value of your estate, but you may lose the opportunity if you don't act early enough.

Setting Up Insurance Policies Incorrectly

Setting up a life insurance policy can increase your family's financial security, or even pay a potential IHT liability.

However, if the policy is not written in trust, any payout will increase the value of your estate. It will also need to go through probate procedures, which can cause delays.

Using a trust means that benefits can be paid out quickly and without adding to the IHT burden. The premiums for a policy in trust are treated in the same way as regular gifts.

The good news is that if you have existing insurance policies, it is not too late to place them in trust. If your policy has any lifetime benefits (for example, critical illness cover), you can decide whether this should be paid into the trust or directly to you.

Giving Away Assets You Still Need

It is not advisable to give away capital that you might need in the future. With costs and life expectancy increasing, there is no point in saving IHT if this will leave you short of money later in life.

For many people, the family home is the main asset. It might seem like a good idea to pass this on during your lifetime to reduce the value of your estate. However, giving away assets you still use can be ineffective for IHT planning unless you pay a commercial rent rate.

If your estate includes a family home which is passing on to direct descendants, you can claim the Residence Nil Rate Band. This is up to £175,000 per individual (£350,000 for a couple passing on a jointly owned property), capped at the value of the property. Giving away the property means missing out on this relief.

Not Seeking Advice

Estate planning is complex, and there are multiple opportunities available, as well as pitfalls to avoid. A financial planner can help you navigate the options, taking into account your goals and your circumstances. Potential options include:

- Undertaking cash flow planning to work out how much you can afford to give away and when.
- Setting up trusts to allow you to ringfence assets and save IHT. Some trusts even allow you to draw an income, balancing tax benefits with flexibility.
- Using your assets in the most effective way. For example, pensions are often outside of the estate for IHT purposes under current rules, but this depends on scheme structure and legislation, which may change.
- Making use of business relief, either through your own company or by buying shares in small businesses.

All of these options have their benefits and risks, and a combination of approaches could work best, particularly for larger estates.

Please don't hesitate to contact a member of the team to find out more about estate planning.

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