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Leaving a legacy

Inheritance Tax and the various aspects involved in estate planning.



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The importance of estate planning

Successful estate planning helps you to better control the amount of tax you are liable to pay on any wealth you accumulate over your lifetime.



You've worked hard to build up your current wealth. You may have taken risks, devoted long hours to building up your business or made sacrifices to establish your investment portfolio.

At the same time, you've probably paid a significant amount of tax in the form of:

- | Income tax
- | Corporation tax
- | Capital Gains Tax
- | Stamp Duty Land Tax
- | National Insurance
- | And then, of course, there's Inheritance Tax (IHT)

While IHT may be a legitimate concern for you and your beneficiaries, there is more to estate planning than simply trying to reduce the Taxman's slice of your legacy.

Your savings and investments, car and any rental properties form a part of your estate. Not forgetting any jewellery you have, household furniture, or expensive paintings (minus any liabilities, like an unpaid mortgage).

After working out the value of your belongings, you may be surprised by how much your estate comes to. It could be worth a lot more than you think. It's also important to bear in mind that these assets could increase or decrease in value in the future.

To start with, it's important to think about what you'd like to happen to your wealth when you die.

For example:

£ What should any surviving spouse or partner inherit?

👤 Who are your (other) chosen beneficiaries?

🕒 Are there any specific items you would like to leave to certain people?

By answering these questions, you'll greatly help us to help you with your estate planning. Your responses may also help you to consider whether making lifetime gifts could be a sensible option.

HM Revenue & Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes, which cannot be foreseen.

Please contact an accountant or tax specialist for specific tax advice.

As a general rule, if you live in the UK and consider it to be your permanent home, then you are regarded as having UK domicile and your entire estate, wherever it is situated, will be subject to UK IHT. This guide only considers the UK domicile situation.

This guide is based on the IHT figures for the 2024/2025 tax year. The current nil-rate band for IHT is £325,000.

An introduction to Inheritance Tax (IHT)

How much can I expect to pay?

At its simplest, IHT is a 40% tax generated upon death that applies to the amount by which your estate exceeds the nil-rate band, which is currently £325,000 for the 2024/2025 tax year.

Your overall estate will include any gifts made in the seven years preceding your death (unless the gifts are covered by exemptions).

There are plenty of perfectly legal steps you can take to protect your family's wealth from the taxman. The inheritance tax solutions include annual exemptions, allowances, direct gifts and trusts.

Of course, there are many different options to choose from – so it's important you find one that's right for you. With this in mind, and the fact that inheritance tax can be a complex subject, it's worth speaking to a Financial Adviser. They can point you in the right direction, guide you through the complexities – and help you put suitable plans in place.



IHT exemptions and reliefs

There are a range of exemptions and reliefs that can help reduce your IHT liability.

Spouse or civil partner exemption

Any amount left to your spouse/civil partner in your Will is exempt from IHT. The same applies for lifetime gifts to your spouse/civil partner as long as they are permanent UK residents. There are no exemptions for unmarried couples or 'common-law' spouses

Transferable nil-rate band

If a spouse/civil partner does not use their entire nil-rate band when they die (e.g. because their entire estate passes to their widow(er)), then the unused portion is added onto their estate when the second partner dies. According to 2024/2025 tax year rates, this means that if each spouse's Will leaves everything to the surviving partner, then the threshold before tax becomes payable will increase to the equivalent of two nil-rate bands (i.e. a maximum of £650,000).

Residence Nil Rate Band (RNRB)

Couples with direct descendants and who have an estate (which includes their main residence) exceeding the IHT threshold may be eligible for this relief. Effectively, it introduces an additional threshold on top of the current £325,000 nil-rate band, making it easier to pass on the family home without incurring IHT. The RNRB for 2024/2025 is £175,000.

Annual exemption

In addition to being able to gift as much as you like to your spouse or civil partner, you're also permitted to make IHT-free gifts of up to £3,000 each tax year. Even better, you can carry this exemption forward (for one tax year only) – but only after you have used the current year's exemption. It is possible to use this exemption (including any amount carried forward) as part of a larger gift.

Small gifts exemption

You can make small gifts of up to £250 to as many people as you like and these gifts will all be exempt from IHT. However, this exemption does not apply to anyone to whom you have gifted money in the current tax year using your £3,000 annual exemption.

Normal expenditure gifts exemption

If you make regular gifts out of your income that do not reduce your standard of living (e.g. regular pension contributions for family members), these will also be exempt from IHT. This can be useful if you have spare income, whatever the source.

Wedding/civil partnership gifts

Gifts made to someone who is getting married or registering a civil partnership are exempt from IHT up to a certain threshold, which depends on your relationship to the parties. A maximum of £5,000 can be gifted by parents to their child, £2,500 by grandparents to their grandchild, and £1,000 to anyone else.

Charitable gifts

Any amount of money you gift to a UK-registered charity is exempt from IHT. In addition, if you leave 10% or more of your taxable estate to charity, the IHT rate levied on your estate will typically be cut to 36%.

Agricultural property relief

If you own all, or part of, a trading business or farm, you may be entitled to other valuable reliefs. The rules are complex, but in broad terms:

- | Agricultural Relief is due at 100% if the landowner farmed it themselves, if the land was used by someone else on a short term grazing licence, or if it was let on a tenancy that began on or after 1 September 1995. Relief is due at a lower rate of 50% in most other cases.

Taper relief

In the unusual circumstance that you make lifetime gifts that attract tax, either during your lifetime or within the seven years preceding your death, the recipient(s) may benefit from taper relief. This relief reduces the amount of tax payable when you die, if the gift was made more than three years before your death.

Agricultural shares and securities

Some company shares and securities are eligible for Agricultural Relief if their value:

- | Gave the deceased control of the company at the time of their death and comes from agricultural property that forms part of the company's assets.
- | There are also rules relating to the sale of related property within three years of the owner's death.

These reliefs will often allow family enterprises to be passed on completely free of IHT if the appropriate conditions are met. If you think they may be relevant, then, advice is absolutely vital to ensure you receive the relief you're entitled to.

Don't invest unless you're prepared to lose all the money you invest. Business Relief is a high-risk investment. You may not be able to access your money easily and are unlikely to be protected if something goes wrong.

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Think about how you use your pension

Money built up in a pension usually doesn't count towards your estate. This normally means you can leave behind a pension without your loved ones paying inheritance tax on it.

**Before
75**

If you keep money in your pension fund and you die before reaching age 75, then the remaining fund can usually be paid as a tax free lump sum to your beneficiaries.

**After
75**

If you died after reaching age 75, then remaining fund can be paid to beneficiaries but is treated as earned income when they receive it. They might choose to take the benefit when they are paying lower rates of income tax, eg. after they retire.

Overall this could mean that less is paid in tax than would be the case if the funds were part of your estate.

Thanks to the pension freedoms, you don't necessarily have to use your pension to fund retirement. Instead, it might be better to deploy other pots of savings to fund your lifestyle. That way, you are first using up funds that are likely to attract an inheritance tax liability, whilst retaining funds which might not be liable in future (eg. your pension funds).

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Why your Will matters

A Will is a key part of estate planning – not just because it sets out what you want to happen to your wealth when you die, but also because it covers a number of other important aspects.

There are a number of important considerations to take into account when drawing up a Will. These can be summarised as follows:

Who should your executors be?

You need to decide who will be responsible for carrying out (i.e. 'executing') the terms of your Will. Ideally, you should appoint two or more executors. Think carefully before appointing your surviving spouse or partner as an executor, as coping with estate administration while grieving can be a heavy burden to bear.

What powers do you wish to give your executors and trustees?

Usually, Wills are drafted to give maximum flexibility to executors, as well as to the trustees of any trusts it creates. However, you can impose constraints if you wish (for example, requiring trustees to consider a surviving spouse's wishes).

What are your funeral wishes?

Your Will can determine whether you'd like to be buried or cremated and (if the latter) specify where you'd like your ashes to be scattered.

If your children are minors, who should be their guardian?

This can be a difficult question to resolve, but it is fundamental to address and agree it with your chosen nominees. Guardianship could be a long-term commitment and is not a responsibility to be taken lightly.

Who gets what, when and how?

The distribution part of your Will sets out what will happen to your estate, and potentially has significant IHT consequences. You will need to ask yourself:

- | Are there specific items you would like to gift to particular beneficiaries? — How should gifts to minors be dealt with? This will normally involve some form of trust, at least until the child reaches 18 (16 in Scotland).
- | Would you prefer your surviving spouse or partner to receive a lump sum to be managed as they see fit, or would you prefer to set up a trust to provide them with an income, with capital passing to children or grandchildren after their death? This may be particularly relevant if you have children from a previous marriage.
- | Would you like the balance of your estate (after any specific transfers to your surviving spouse or partner) to pass outright to your chosen beneficiaries?

Anything you jointly own – most commonly your home – will usually pass automatically to the surviving joint owner(s) outside of your Will (although it remains part of your IHT-liable estate). The exception to this is if ownership takes the form of 'tenants in common', in which case your Will determines what will happen to your share.

The decisions you make in your Will are legally binding when they take effect. A poorly drafted Will could therefore create problems for your executors and beneficiaries.

Will Writing and Trusts are not regulated by the Financial Conduct Authority.



Review your Will regularly

You should review your Will on a regular basis, as you would any other aspect of financial planning. Your wishes and/or circumstances may change. If you get married, your Will is usually revoked; on the other hand, if you get divorced, your Will remains valid but your ex-spouse/partner will be treated as pre-deceasing you once the divorce is finalised.

In theory, Wills can be rewritten by your adult beneficiaries after your death via a Deed of Variation; however, relying on this route to correct errors is not recommended. Unsurprisingly, some beneficiaries may be unwilling to reduce their entitlements, even if it could mean tax savings for others.

Please note, Will writing is not part of our offering.

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The consequences when you don't leave a Will...

If you die without a Will, the rules of intestacy will determine how your estate is to be distributed.

The rules of intestacy vary depending on where you live in the UK. England and Wales share the same rules, and Northern Ireland's are very similar. Scotland, however, takes a markedly different approach.

Your estate distributed according to intestacy rules is unlikely to correspond with what you would put in your Will and could contribute towards an unnecessarily high IHT bill. As in the case of Wills, a Deed of Variation could offer an escape route; however, any changes involving minors would need the consent of the Courts, which may not be forthcoming.



Case Study: The perils of intestacy

Colin was born in Scotland and moved to England after leaving university, remaining there until he died.

Colin's estate was worth **£600,000** when he died, including **£200,000** which represented his half-share of the jointly-owned family home. Colin hadn't made a Will, thinking that everything would pass to his wife, Jane, and that their 55-year-old son William (who was already a millionaire) would receive nothing. However, that is not the way intestacy rules worked.

The property did indeed pass outright to Jane because she jointly owned it with Colin. And, as Colin had acquired an English domicile, the balance of the estate after the property passed to his wife and all debts and any applicable IHT was paid was subject to laws of intestacy in England.

This means that his wife would inherit his personal property and belongings and the first **£270,000 of the estate**, but only half of the remaining estate, with the other half passing to any living beneficiaries. Therefore:

Jane received the first **£270,000, plus half the remaining estate.**

William received the **other half of the estate.**

When Jane dies, **William** will then receive **whatever value remains in Jane's life interest trust.**

In theory, it's simple: to avoid unnecessary IHT liabilities, you need to make sure you have made enough outright gifts, and sufficiently long ago, to mean that (with a valid Will) your estate (including gifts added back from the past seven years) is less than the available nil-rate band when you die (currently £325,000).

In reality, life does not happen that way, because:

- | You don't know when you're going to die.
- | You'll want to make arrangements for your spouse or partner.
- | You may be wary of making too many lifetime gifts, as you may need the money in later life (perhaps to cover care costs).
- | You may not think it wise to make lifetime gifts while the recipients are still relatively young.
- | You may not be able to afford to make sufficient lifetime gifts.

This is why estate planning is about trying to find compromises between theory and reality, which is made all the more difficult by a range of anti-avoidance provisions.

It will frequently involve a holistic approach; for example, how you arrange your retirement plans will usually have a knock-on effect on your eventual IHT liability.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

The most important estate planning tools include:



Wills

A carefully drafted, up-to-date Will.



Lifetime gifts

These are favourably treated under IHT rules, particularly outright gifts. In most cases, they won't attract any tax when they are made, and will be completely tax-free if you survive for the next seven years. However, a lifetime gift means just that: anti-avoidance rules prevent you from retaining any significant interest in what you claim to be a gift. For example, you cannot put your holiday home in your children's name and continue to treat it as your own.



Trusts

These allow you to control the gifts you make by way of a third party (i.e. the trustees) who will act as an intermediary between yourself and your beneficiaries. You can choose the trustees and can even be one yourself, if you wish. Your trustees' actions are governed by the terms of the trust set up to receive the gift. These terms can be as rigid or flexible as you want.



Exemptions

These are generally small, but regularly making use of them can help whittle down your taxable estate over time. The normal expenditure gifts exemption is a good example of this; giving away investment income that you would otherwise allow to accumulate is a straightforward and painless way of reducing your estate.



Reliefs

Business and agricultural reliefs are generous for both businesses and landowners. Even if you do not currently fall into either ownership category, you may still be able to benefit from these reliefs by making and holding appropriate investments. It may even be possible to secure business relief through an Individual Savings Account (ISA). Whenever you make an investment to secure business property relief, it is essential to carefully consider the risk you are exposing yourself to.

Don't invest unless you're prepared to lose all the money you invest. Business Relief is a high-risk investment. You may not be able to access your money easily and are unlikely to be protected if something goes wrong.



Tailored investment products

Over the years, investment products have been developed that go some way towards allowing you to make a gift and retain the income from it (something IHT anti-avoidance rules are designed to prevent). It may be possible to use existing investments in such products, thereby mitigating the tax and other consequences of their sale and reinvestment.



Pension arrangements

These do so much more than simply providing you with retirement income. For example, the lump sum death benefits that feature as part of most pension arrangements are usually IHT-free if the pension holder passes away before the age of 75. During your retirement, a solid pension income will make it much easier to make lifetime gifts or take advantage of the normal expenditure gifts exemption.



Life assurance

If planning cannot eliminate all of the potential IHT liability on your estate (and usually it won't) then life assurance can be a valuable backstop. IHT is due six months following the last day of the month of death; therefore, an appropriate life policy can help to pay that bill. Otherwise, your executors may need to take out a loan, as they cannot realise the assets in your estate until they have been granted probate – which in turn cannot take place until the IHT bill is settled.

Let's talk

Making informed decisions about how you pass on your wealth is a positive and empowering thing to do. We know there's a lot to think about. That's why we're here to help you explore the options, have the conversations and put plans in place.

We could help sort your assets, calculate how much tax your estate is likely to pay and potentially help reduce the possible liability.

Our team of financial advisers are here to talk about your personal circumstances. They'll take the time to understand your wishes. You'll receive recommendations tailored to your needs to consider. There is also no obligation to act on the advice we will provide.

If you're not sure how much your estate might have to pay or how you could reduce it, we could help.

Speak to a member of the team to arrange an appointment with your local Newcastle Financial Adviser, available in branch, over the telephone or by video.

An ISA is a medium to long term investment, which aims to increase the value of the money you invest for growth or income or both. The value of your investments and any income from them can fall as well as rise. You may not get back the amount you invested. HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

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