

# UNDERSTANDING INHERITANCE TAX PLANNING AND **THE** **ROLE OF TRUSTS**



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# UNDERSTANDING INHERITANCE TAX PLANNING AND **THE ROLE OF TRUSTS**

The financial world is evolving, and one of the most remarkable changes anticipated in the coming decades is the intergenerational transfer of wealth. By 2047, it is estimated that £5.5 trillion will be passed down in inheritances across the UK<sup>[1]</sup>. Despite the scale of this wealth transfer, many families are unprepared to manage these transitions efficiently. Without a solid financial plan, the hard-earned fortunes of one generation may fail to benefit the next or, worse, may be significantly diminished.

Inheritance Tax (IHT) planning is essential for preserving wealth for future generations. It encompasses more than just limiting tax liabilities; it's about determining how you want your legacy to be managed while tackling critical questions regarding your estate. If you reside in Norfolk, Suffolk, or Essex, now is the ideal time to take proactive steps to safeguard your family's financial future, especially in light of the announcements related to IHT in the Autumn Budget Statement 2024.

## WHAT IS INHERITANCE TAX?

First, let's discuss Inheritance Tax (IHT). This tax applies to the value of an estate that exceeds a certain threshold upon a person's death. Current regulations in the UK require that estates valued above the nil-rate band (£325,000) are subject to a 40% tax rate. For many families, IHT presents a significant financial challenge, often forcing relatives to liquidate assets to meet the tax obligation.

Inheritance Tax planning involves implementing strategies to legally

reduce or eliminate this tax burden.

This may include gifting assets, utilising trusts, or exploring available reliefs and exemptions to preserve the maximum amount for your beneficiaries. This planning ensures that your loved ones receive the wealth you worked hard to create, rather than losing a substantial portion to HM Revenue & Customs.

## WHAT IS THE RESIDENCE NIL RATE BAND (RNRB)?

The Residence Nil Rate Band (RNRB) is an extra tax-free allowance introduced by the UK government to tackle the increasing value of family homes. This allowance allows individuals to transfer their main residence to direct descendants, such as children or grandchildren, without incurring additional IHT.

For the current tax year, the RNRB is set at £175,000 per person. This means



that, when combined with the standard nil-rate band of £325,000, individuals can potentially shield up to £500,000 of their estate from IHT. For married couples or registered civil partners, unused portions of both the nil-rate band and the RNRB can be transferred, allowing up to £1 million to be passed on free of IHT.

### **WHY IS RNRB ESSENTIAL FOR FAMILIES?**

The RNRB has provided much-needed tax relief for families, particularly in areas like Norfolk, Suffolk, and Essex, where property values have significantly increased in recent years. Without this allowance, many families would face insurmountable tax bills, often requiring the sale of their homes to settle the debt.

However, certain conditions must be met to qualify for the RNRB. The property in question must be a primary residence and should be left to direct descendants. Additionally, estates

exceeding £2 million will begin to lose the RNRB allowance on a tapering basis. For these larger estates, careful planning is essential to ensure that the allowance is utilised effectively.

### **HOW TO MAXIMISE THE BENEFITS OF RNRB**

Maximising the benefits of the RNRB requires careful estate planning. One effective strategy is to downsize your property while keeping the intended beneficiaries in mind. Even if you sell your family home for a smaller property or release equity, the RNRB can still apply, provided the proceeds are left to qualifying descendants.

Additionally, trusts can play a crucial role in estate planning regarding the RNRB. While the RNRB is typically lost if a property is placed in a discretionary trust, other structures may still allow for its utilisation. Partnering with the highly experienced advisory team at DG Financial

will ensure that your estate is organised to comply with these requirements while safeguarding your wealth.

### **WHY IS IT IMPORTANT TO PLAN YOUR LEGACY?**

Neglecting to address IHT can lead to substantial financial and emotional repercussions for your heirs. Without a strategy in place, your beneficiaries may encounter unforeseen difficulties, such as hefty tax liabilities and possible disagreements regarding the division of your estate. Thoughtful planning not only conserves resources but also offers clarity, structure, and peace of mind.

Additionally, estate planning provides you the chance to reflect on your values and priorities. Are there specific causes or organisations you wish to support? Do you want to offer equal financial support to all family members or make special arrangements for those with unique needs? Considering these factors





enables you to create a legacy that aligns with your personal principles.

## HOW TRUSTS PLAY A CRITICAL ROLE

Trusts are among the most effective tools available in estate planning. These legal arrangements enable you to place assets under the management of a trustee, ensuring they are distributed to beneficiaries according to your wishes. Trusts offer unparalleled flexibility and control over how your wealth is managed, which is especially beneficial in complex family dynamics or business ownership scenarios.

By placing assets into trusts, families cannot only maintain control but also reduce the taxable value of their estate. Trusts ensure efficient wealth management and protection from unforeseen issues, such as spendthrift

beneficiaries or external claims, including divorce settlements.

## TYPES OF TRUSTS AND THEIR USES

The choice of trust depends on your specific circumstances and estate planning goals.

### Here's a breakdown of some of the most commonly used trusts and their advantages:

#### DISCRETIONARY TRUSTS

Discretionary Trusts offer flexibility by allowing trustees to decide how and when beneficiaries receive their inheritance. This can be particularly useful for protecting wealth from being mismanaged by young or vulnerable beneficiaries, as trustees are empowered to assess the timing and amount of distributions.

These trusts also protect against potential changes in beneficiaries' circumstances, such as divorce or bankruptcy, ensuring that assets stay within the family. For instance, a family in Norfolk might utilise a Discretionary Trust to prevent assets from being included in an heir's divorce settlement.

#### BARE TRUSTS

Bare Trusts create fixed arrangements where the beneficiary has an absolute right to the trust's assets. Often utilised to hold assets for minors, Bare Trusts guarantee that the assets are securely managed until the beneficiary reaches maturity. Unlike Discretionary Trusts, beneficiaries cannot be replaced or altered, making them a clear choice for those with direct, unchanging inheritance plans.

For instance, parents in Suffolk might set up a Bare Trust to hold educational

funds for their children, ensuring these funds are preserved and utilised solely for tuition or other academic needs.

### LIFE INTEREST TRUSTS

A Life Interest Trust is generally used to provide income or benefits to one individual for their lifetime while preserving the main assets for other beneficiaries. These trusts are often employed in estate planning for blended families to ensure that a spouse is supported while also guaranteeing that the deceased's children receive their inheritance.

For example, a client in Essex may place a property into a Life Interest Trust, allowing their spouse to live in the home rent-free during their lifetime. After that, ownership will pass to their children.

### TRUSTS AND TAX EFFICIENCY

One of the key advantages of trusts is their ability to protect assets from IHT. Under certain trust structures, the assets held within them are not deemed part of the estate, which lowers the overall taxable value. This is particularly significant in high-value regions such as Norfolk, Suffolk, and Essex, where rising property prices often push estates beyond the nil-rate and RNRB thresholds.

Trusts can also facilitate gifting strategies. By placing non-cash assets, such as property or investments, into a trust, you may benefit from taper relief

after seven years, potentially reducing or eliminating IHT exposure altogether.

### HOW TRUSTS HELP NAVIGATE COMPLEX FAMILY DYNAMICS

Modern family dynamics, such as blended families and disputes among heirs, can complicate estate planning. Trusts offer solutions to these complexities. For instance, trusts can be utilised to ensure that only designated individuals benefit from your estate. This may include safeguarding assets against claims from ex-spouses or in-laws.

They can also address situations where a beneficiary wishes to renounce their inheritance to pass it on to their children. Using tools like a Discretionary Trust, such changes can be accommodated flexibly while maintaining control over the outcome.

### COMMON SCENARIOS FOR USING TRUSTS

Trusts are particularly beneficial for addressing life events and transitions.

#### Here are three scenarios where trusts can provide significant advantages:

**Ensuring Children's Future:** For families in Norfolk, a discretionary trust could safeguard educational funds for grandchildren while protecting the capital from misuse.

**Protecting Business Assets:** Essex business owners might use a Family Trust to ensure continuity. The trustees retain control until the next generation is ready to take over.

**Catering to Special Needs:** Trusts can safeguard assets while supporting a disabled child in Suffolk, ensuring their future care without disqualifying them from state assistance.

### WHY REVIEW YOUR TRUSTS REGULARLY?

Life events like remarriage, births, or legislative changes can influence the relevance and effectiveness of your trust arrangements. Regular reviews ensure that your estate planning strategies remain in line with your wishes and family dynamics.

For example, you may need to modify existing trusts to accommodate increases in property value or changes in RNRB qualifying conditions. Regular consultations with DG Financial, serving Norfolk, Suffolk, and Essex, will help identify these adjustments and ensure optimal tax efficiency.

### NEW INHERITANCE TAX RULES EXPLAINED POST THE AUTUMN BUDGET STATEMENT 2024

The announcements in the Autumn Budget Statement on 30 October 2024 have introduced significant changes to

IHT rules that could greatly impact estate planning. These adjustments present new considerations for families, business owners, and individuals aiming to protect their wealth for future generations. To assist you in understanding how these changes may affect you, we will outline the key updates and their implications.

### DEFINED CONTRIBUTION PENSIONS NOW LIABLE FOR IHT

One of the most significant changes is that, from April 2027, defined contribution (DC) pensions will no longer be exempt from IHT. Some defined benefit (DB) pensions may also fall under this new guidance. Previously, pensions were often considered a tax-efficient way to pass on wealth to beneficiaries, but this exemption will soon no longer apply.

This change has a substantial financial impact on estates that exceed the IHT thresholds. For example, a DC pension balance of £1 million within an estate already liable for IHT could result in an additional tax bill of £400,000. This adjustment highlights the need to reassess retirement strategies and consider tax planning alternatives to protect one's legacy.

### WHAT THIS COULD MEAN FOR YOU

If you rely on your pension as part of your wealth transfer plan, it's crucial to revisit your strategy. Consider exploring other tax-efficient options, such as trusts

or life insurance policies, to minimise the overall tax burden on your estate. Collaborating with DG Financial will ensure we can help you identify the most appropriate solutions tailored to your unique circumstances.

### NEW CAPS HAVE BEEN INTRODUCED FOR BUSINESS RELIEF AND AGRICULTURAL RELIEF

Agricultural property relief and business relief (BR) have previously offered up to 100% exemptions, making them highly effective tools for mitigating IHT. Assets such as family farms, businesses, and specific investment products have traditionally benefited from these exemptions.

However, under the new rules, changes will come into effect that reduce the scope of these reliefs.

From April 2027, there will be a tax-free allowance of £1 million for assets qualifying under agricultural property or business relief. Any value above this threshold will receive 50% relief rather than the full exemption. This results in an effective IHT rate of 20% on eligible assets over £1 million.

### UNDERSTANDING THE IMPACT

Family farms and businesses in areas like Norfolk, Suffolk, and Essex may confront new tax challenges. For instance, a farm valued at £2 million would receive a £1 million tax-free allowance, but the remaining £1 million would qualify for 50%

relief. This change could result in an additional IHT bill of £200,000. Planning strategies such as restructuring business ownership or utilising alternative relief schemes may help mitigate these new liabilities.

### AIM SHARES ALSO LOSE THEIR 100% EXEMPTION

The changes extend beyond farms and businesses to include investments. Alternative Investment Market (AIM) shares, previously exempt from IHT if held for at least two years at the time of death, will also be affected. Unlike agricultural property and business relief, AIM shares will not benefit from the £1 million tax-free threshold.

This adjustment means the full value of AIM shares will now be subject to IHT, making them less attractive as an estate planning tool. Investors relying on AIM shares for tax efficiency will need to reassess their portfolios to account for potential inheritance tax liabilities.

### EXPLORING NEW INVESTMENT STRATEGIES

If a significant portion of your wealth is tied to AIM shares, now is the time to explore tax-efficient alternatives. Diversifying your portfolio with different investment options or transferring specific assets into trusts could offer beneficial solutions. Professional guidance is essential to ensure your investment strategies align with your estate planning objectives.





## IHT THRESHOLD FREEZE EXTENDED UNTIL 2030

Adding to these changes, the government has announced that the existing nil-rate band (NRB) of £325,000 and the residence nil-rate band (RNRB) of £175,000 will remain frozen until 2030. Previously, inflation-based increases were set to begin in 2028, but this extension keeps the thresholds unchanged for an additional two years.

This freeze means that, as inflation and property values rise, more estates will surpass these static thresholds, leading to increased IHT liabilities. Without proactive planning, families may encounter greater financial burdens when transferring wealth to the next generation.

## GETTING READY FOR THE FREEZE

If your estate is nearing or exceeds the current thresholds, take time to review

your assets and explore planning options. For instance, gifting portions of your wealth during your lifetime, setting up trusts, or downsizing properties could help reduce the taxable value of your estate. Discussing these strategies with financial and legal professionals ensures your plans remain compliant and effective.

## PLANNING CONSIDERATIONS UNDER THE NEW IHT RULES

The Autumn Budget Statement has introduced significant changes to IHT rules, leaving many families—particularly those with farms or small businesses—worried about how their heirs will manage future estates. The new rules could pose challenges for maintaining family assets, potentially forcing the sale of cherished properties or businesses to meet tax liabilities.

The good news? There are still several strategies to mitigate these risks. Effective

estate planning has become even more crucial, and taking early action can make a significant difference. Below, we explore key areas to consider in light of the changes and the steps you can take to protect your wealth for future generations.

## RECONSIDER PENSION DRAWDOWN STRATEGY AND DEATH BENEFITS

Historically, defined contribution pensions have been a cornerstone of tax-efficient estate planning, as they were exempt from IHT. Many individuals structured their retirement income by leaving pensions untouched, instead relying on ISAs, cash savings, and other assets to minimise the value of their taxable estate. However, under the new rules taking effect in April 2027, pensions will be subject to IHT, necessitating a complete reevaluation of these strategies.

Estate plans must now address this change, particularly regarding death benefits within pension schemes. The order in which funds are withdrawn from pensions and other investments should be carefully considered. For example, it may be more advantageous to use pension assets first to reduce an IHT bill. The ability to give lifetime gifts, along with investigating insurance solutions to cover potential liabilities, will also become crucial components of the advisory process moving forward.

### EVALUATE OWNERSHIP OF AIM SHARES AND BR INVESTMENTS

Investing in Alternative Investment Market (AIM) shares and business relief (BR) qualifying investments has long been a strategy for reducing IHT. Previously, these assets qualified for a 100% IHT exemption if held for at least two years at the time of death. However, the tax benefits have now been significantly reduced.

Post-2027, AIM shares will lose their IHT exemption entirely, while BR assets will receive a partial exemption with a new £1 million threshold, above which assets qualify for only 50% relief. Investors must now weigh the opportunity cost of retaining these investments against other tax-efficient options. Additionally, AIM shares and BR schemes often restrict access to funds

and involve investment risks, which should be factored into decision-making.

For those who heavily rely on these schemes, diversifying into alternative investments or exploring trust arrangements may be wise. By seeking professional financial guidance from DG Financial, we can assist you in weighing the benefits against potential drawbacks and aligning strategies with estate planning goals.

### ADDRESS THE LIQUIDITY CHALLENGES FACED BY BUSINESSES AND FARMS

The change to BR and agricultural relief presents specific challenges for family farms and small businesses. These assets will no longer benefit from the 100% IHT exemption they previously held. For instance, a family farm valued at £5 million could have been passed on tax-free before. Under the new rules, the first £1 million remains exempt, but the remaining £4 million is subject to IHT, resulting in a liability of £800,000.

This shift creates difficulties for businesses and farms with high asset values but limited cash flow. Without proper planning, raising the funds to pay the tax bill could lead to forced sales of land, equipment, or property. Early succession planning is now more vital than ever to preserve these legacy assets. Owners should review succession strategies, consider restructuring

ownership, and explore potential reliefs to minimise cash flow pressures associated with tax obligations.

### UPDATE WILLS TO REFLECT THE NEW RULES

A fundamental yet essential step after these changes is to review and update your Will. Many existing Wills may no longer reflect current tax regulations, and this discrepancy could lead to unintended consequences or additional liabilities.

While the changes do not take effect immediately, providing approximately 18 months for preparation, families should use this time to revisit their estate planning strategies. Conducting a comprehensive estate review can help ensure that Wills align with the new rules and account for any potential legislative adjustments before implementation.

### REVIEW PROTECTION STRATEGIES

Sometimes, no matter how robust an estate plan is, an IHT liability remains that cannot be eliminated. Life insurance policies can provide a practical solution to mitigate this challenge. Properly structured policies can cover significant tax bills or protect against IHT liabilities on large lifetime gifts.

However, care must be taken to ensure these policies are effectively executed. Policies that are written incorrectly or outside of trust structures could





exacerbate IHT issues rather than resolve them. Professional advice ensures that protection tools work in harmony with the rest of your estate plan.

### IMPLEMENTING A THOUGHTFUL AND SYSTEMATIC APPROACH

Despite the urgency surrounding these announcements, rushing into decisions isn't always the most effective strategy. There is still time to carefully review, reassess, and reconfigure estate planning strategies. Considerations regarding gifting, investment redirection, and trust establishment should be intentional to ensure their suitability for individual circumstances.

A measured strategy offers flexibility to adapt to future changes and possible refinements in tax legislation. With professional advice, families and business owners can ensure their plans remain resilient and compliant, regardless of what the final rulings may entail.

### IS IT TIME TO TAKE CONTROL OF YOUR LEGACY?

The changes to IHT rules in the Autumn Budget Statement highlight the increasing importance of proactive estate planning. Whether you are navigating the complexities of family businesses, assessing investment options, or structuring lifetime gifts, taking early action is essential for preserving your wealth. ■

If you live in Norfolk, Suffolk, or Essex, DG Financial is here to help you navigate these changes and safeguard your legacy for future generations. Contact us today to schedule a consultation and discover tailored strategies for managing your estate under the new IHT rules. Together, we can create a plan that ensures your family's financial wellbeing for years to come.

#### Source data:

[1] M&G Wealth – Family Wealth  
Unlocked Report 2022. Available at:  
<https://www.mandg.com/dam/pru/shared/documents/en/fwu-report-final-version-20-april-2022.pdf> October 2024

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