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Inheritance Tax Planning

Inheritance Tax is payable on your assets when you die, but brings within its scope certain lifetime gifts. There are a number of ways in which it can be reduced or avoided entirely. This fact sheet provides you with some basic information in order to help you assess whether further Inheritance Tax planning advice and measures would be of benefit to you.

Lifetime gifts

Certain lifetime gifts attract exemptions from Inheritance Tax: -

• Gifts between a husband and wife (subject to domicile)		No limit
• Gifts to charity (UK)		No limit
• Annual exemption each tax year per donor		£3,000
• Small gifts to any number of persons		£250
• Wedding gifts	by parents	£5,000
	remoter ancestor	£2,500
	party to marriage	£2,500
	others	£1,000
• Gifts which are normal expenditure out of income		No limit

During a person's lifetime, most gifts regardless of their size which are not exempt under the above provisions are not subject to an immediate charge to Inheritance Tax but are Potentially Exempt Transfers (PETs). If the donor dies within seven years of making the gift, Inheritance Tax may become payable on PETs. The charge is on the value of the gift at the date the gift was made and is taxed at the rates applicable when the donor dies. The tax is paid by the donee.

Tapering relief may reduce the Inheritance Tax liability if the donor survives for more than three years but less than seven. The reduction is on the rate of tax and not the amount subject to tax and therefore only applies if the value of the gift exceeds the nil rate band on the donor's death and a liability to tax arises.

Years between gift & death	% of full charge at death rate
0 – 3	100
3 – 4	80
4 – 5	60
5 – 6	40
6 – 7	20

Care should be taken before making any gift as although Inheritance Tax may be avoided by making a lifetime gift and surviving for 7 years, an immediate liability to Capital Gains Tax may arise instead.

Gifts on death

a) Assets transferred between a husband and wife on death are exempt for Inheritance Tax purposes provided they both live in the UK. If the surviving spouse is not a UK resident, the Spouse Exemption is capped at £55,000.

b) Assets left to charities on death are exempt.

c) Everyone has a nil rate band (currently £325,000) to give away where the Inheritance Tax charge on assets within this band is 0%. The nil rate band is offset against any lifetime gifts (PETs) made within the seven years before death first, and if there is any balance left over it is offset against assets at the date of death.

   From October 2007, where an individual dies and their spouse has died before them and not utilised all or part of their nil rate band, the percentage of the nil rate band unused on the estate of the first spouse to die can be transferred to the estate of the second spouse to die.

Let us use Mr & Mrs White as an example:

	Mr White £	Mrs White £
House, cash & investments	£400,000	£400,000

Mr White dies first, leaving everything to his wife. There is no tax on his death because gifts between spouses are exempt.

Mr White's assets (left under his Will to Mrs White)	£400,000
Mrs White's assets	£400,000
Total	£800,000

Mrs White then dies, leaving everything to the children:

Total Estate	£800,000
Less nil rate band for Mrs White	£325,000
Less nil rate band transferred from Mr White's Estate	£325,000
Total	£150,000
Tax @ 40%	£60,000

The benefit of the transferable spouse allowance is that whilst it is the percentage of the deceased spouse's unused allowance which is transferred, it is calculated at the current nil rate band rate, not the rate applicable when the first spouse died.

d) To maximise the tax efficiency of an estate there needs to be sufficient assets belonging to each spouse which can be passed down. It may be beneficial to change the ownership of assets, but it is very important that this does not have tax or financial implications during the lifetime.

e) A Will needs to be tailored to individual circumstances. Greater tax savings may be achieved where there are special types of asset, such as business or agricultural property. Some lifetime planning measures may also be recommended.

f) If a Will has not been prepared in order to mitigate Inheritance Tax planning, the beneficiaries have the ability within two years after a person's death to change the way their assets are dealt with. This is by a Deed of Variation. However, this scheme is subject to threat and should not be relied upon as an alternative to having a valid Will in place.

g) Death benefits under personal pension plans or insurance policies may be subject to Inheritance Tax. Tax protection can be achieved by putting the polices into Trust. Similarly, death benefits under an employers scheme can, in some cases, be subject to Inheritance Tax and a valid and up-to-date nomination should be put in place.

h) Insurance policies can be taken out specifically to provide funds to pay Inheritance Tax. Such policies should be put in Trust.

The above information applies for the tax year 2010/2011. Any changes to Inheritance Tax which the Government may introduce need to be reviewed carefully and may affect the rules and proposals summarised above.

For more information contact our Wills, Trusts & Probate team today, email **wtp@goughs.co.uk** or visit our website **www.goughs.co.uk**

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