

## **INHERITANCE TAX & ESTATE PLANNING**

### **INTRODUCTION**

Contrary to popular belief, Inheritance Tax (IHT) is not a tax on the rich only. It affects thousands of families across the UK, especially those who did not see it coming and who hadn't made any plans to reduce the tax bill.

Despite recent reductions in house prices, the ongoing trend is that the value of residential homes increases at a faster rate than inheritance tax relief. This has the effect of catching many people unawares and beneficiaries unwittingly have to pay large amounts of tax.

### **HOW IS THE TAX CALCULATED?**

Your estate is made up of the value of your assets. Assets can include your house and its contents, your personal belongings and any savings or investments you have. The Inheritance Tax **Nil Rate Band** is the amount of the estate on which there is no Inheritance Tax to pay. Inheritance Tax is paid on any estate over this amount. The threshold (i.e. top limit of the nil rate band) for 2008/09 became £312,000. The rate of tax is 40%, so it can really eat into the money you leave to your family. Inheritance Tax can also become due on gifts or transfers of assets during your lifetime. The estate is valued on the day after death. This means that, even if, say, house prices fall and a lesser amount is received on sale, the higher sum is used to calculate IHT.

### **CAN I DO ANYTHING TO AVOID IT?**

Yes, but you have to be prepared. With a little advance planning, you should be able to reduce your liability to tax or avoid it altogether. In fact there are so many exemptions and reliefs from Inheritance Tax, you would be wise to take advantage of them.

### **WHAT IF I'M A BASIC RATE TAXPAYER?**

Many people think they won't be liable for Inheritance Tax if they are paying basic rate tax, but often that is not the case. And, even if your home were worth less than the IHT threshold you'd be surprised how much your estate might be when you add up all your other assets, which might also include the proceeds of a life insurance plan. If you only pay basic rate tax now, you might become a higher rate taxpayer after your death!

### **WHO PAYS THE TAX AND WHEN?**

The tax is normally payable by your beneficiaries on your death. The tax bill must be paid within six months of the death and before Probate is granted. That is before the Will is officially recognised and the estate can be divided up amongst the beneficiaries. This can be very difficult for those inheriting the estate because they may have to sell assets – the family home, for example – in order to pay the tax bill. This often means selling at a loss under pressure to realise capital early. HM Revenue & Customs have the right to be paid first and this timing issue is exactly the sort of difficulty good planning can overcome.

### **TAX EXEMPTIONS AND RELIEFS**

#### **Gifts between civil partners or husband and wife**

Some gifts or transfers of assets are free from Inheritance Tax whenever they occur. One of the most common and genuine gifts are between civil partners or husband and wife, which are always exempt from tax whether they are made before or after death.

### **The Nil Rate Band**

This is one of the most useful planning tools. Careful planning can help to move assets up to the value of the Nil Rate Band out of the estate in the event of the first death, which will then help to minimise the tax payable in the event of the second death. There are various ways of doing this, some can be complex if the surviving partner has a requirement for on-going income and in some cases it can be as simple as re-writing a Will.

### **Transfer of unused Nil Rate Band**

Where a spouse or civil partner dies and has not used their nil rate, the unused amount can be transferred and used by the survivor's estate on their death. This only applies where the survivor died on or after 9 October 2007. In effect, spouses and civil partners between them now have a nil rate band that is worth up to double the amount of the nil rate band that applies on the survivor's death.

For example, if on the death of the first spouse, they leave legacies of £40,000 to each of three children, the sum of £120,000 would be chargeable to IHT. Because this is below £312,000, the legacies pass free of tax and £192,000 (or 61.54%) of the nil rate band is unused. This unused amount can be transferred to the estate of the survivor. If the nil rate band when the survivor dies is £325,000 the Inheritance Tax nil rate band for the surviving spouse would be increased by 61.54% to £525,000.

### **Making gifts during your lifetime**

- Everyone is entitled to give away up to £3,000 p.a. each entirely free from Inheritance Tax. This entitlement can be carried forward to the next year, if it is not used in full in any one year.
- You can also make any number of gifts up to £250 free of tax; however, you can't give more than £3,000 worth of tax-exempt gifts to the same person in one year.
- Regular gifts from normal income that don't reduce your standard of living are also exempt from tax. There is no maximum limit on this exemption, but you must make them from your income and not draw out your capital from savings or investments.
- Parents can give up to £5,000 to their children when they get married and grandparents can give up to £2,500. Even well-wishers can give up to £1,000 free of Inheritance Tax.

You can make a gift of any amount to a Registered Charity or national institutions and it will be exempt from tax. Gifts to universities, museums and recognised political parties are also exempt.

### **Are there any transfers made after death that are always exempt?**

Yes. Payments from company or occupational pension schemes are exempt from Inheritance Tax where the trustees have discretion over who benefits. Similarly, death benefits from personal pensions and other life assurance policies can be 'written in trust' to exclude them from the policyholder's estate on death for the purposes of calculating Inheritance Tax.

**Can I make an outright gift before I die to avoid tax?**

Yes you can, but you still have to be careful. If you make a gift during your lifetime, they are called 'Potentially Exempt Transfers'. This means they might be exempt from tax, but only if you survive for seven years after the gift takes place. Otherwise they may be added back in to the estate value. There is a sliding scale of reduction in tax for these gifts where the person making the gift (donor) dies within the seven year period and this is called 'tapering relief'. Effectively the tax liability for these gifts reduces for each year following the date of the gift so that if the donor survives the full seven years, no tax is due on the value of the gift.

Tapering Relief	
Years since making the gift when death occurs	Reduction in tax (percentage)
0-3	nil
3-4	20%
4-5	40%
5-6	60%
6-7	80%
more than 7	no tax

This relief applies to gifts where the total value of the estate exceeds the lifetime Nil Rate Band when the gifts are added back into the estate on death.

**GETTING EXPERT INDEPENDENT ADVICE**

Many people prefer not to think about taxes that are due on their death, but getting expert advice could save you and your family a considerable sum of money. However, knowing about the potential problem is only the start. What you need to do now is make sure you take some action.

Our advice is entirely confidential and we will:

- Discuss your personal financial situation with you
- Help you calculate whether or not you are likely to be liable to Inheritance Tax
- Advise you on the best way to start transferring assets out of your estate now, taking advantage of the various reliefs and exemptions
- Talk to you about some other specialist schemes, using trusts and investments that will allow you to stay in control of your assets and perhaps benefit from them if that is your wish, or
- Help you to protect your estate from the costs of Inheritance Tax by taking out insurance to cover the estimated bill.

As Independent Financial Advisers, unlike people working for one financial institution, we are duty bound to find the best financial products and plans to suit your personal circumstances from the whole market.

If you would like to find out more about Inheritance Tax and Estate Planning, please contact us on 0117 930 2393 or e-mail [info@burnsandersonifa.co.uk](mailto:info@burnsandersonifa.co.uk). Please note that the FSA does not regulate tax advice.

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