Inheritance Tax Planning

Important Note - The intention of this document is not to provide IHT advice, but to provide a summary of the main allowances for information only.

The first step

Everyone should have a will in place to ensure that on death your assets are distributed according to your wishes. This ought to be reviewed from time to time to make sure it remains relevant and this ought to be the case where circumstances changes for whatever reason.

It is also sensible to consider the benefits of setting up a power of attorney for both financial and health and welfare decisions, which can be applied on line and lodged with the Office of the Public Guardian along with a fee of £82 per person per application.

Use the allowance and exemptions

IHT allowances – immediately deemed to be outside the estate

- Each tax year £3,000 can be given by an individual to their children or anyone else.
- If this allowance has not been used for the previous tax year it can be brought forward to the current tax year and enable a maximum of £6,000 to be paid.
- There are further gifts which can be made – for example, £5,000 per parent to a child on his or her wedding day or £250 to anyone in any one year.
- Regular gifts can be made from your income, which the Revenue will view as being outside of your estate if it is regular and does not impact on your own standard of living.

IHT exemptions

- The nil rate band (NRB) of £325,000 each is applied to your estate
- There is now a residence nil rate band (RNRB) of £125,000 each, rising to £175,000 in 2020/21, where the value of your home is at least £350,000 and where the eventual beneficiaries are your children, which includes adopted and step-children.
  Should the value of the estate exceed £2 million this allowance is reduced by £1 for every £2 which is in excess.

Potentially Exempt Transfers - PETs

- This allows the transfer of assets of any value to be potentially exempt from charge on the settlor surviving for a period of time.
- Upon transfer the gift is potentially exempt only becoming fully exempt from your estate after seven years.
- Where the gift exceeds the nil rate band a sliding scale applies to the tax payable during the seven-year period, for the excess only.

Years 1 – 3 no reduction to the tax
Years 4 20% reduction in the tax payable
Years 5 40% reduction in the tax payable
Years 6 60% reduction in the tax payable
Years 7 80% reduction in the tax payable

Mitigating IHT

There are a variety of options available but the simplest way of saving IHT is to gift money away and then survive for seven years.

The problem is that you need to identify assets you will no longer require.

Charitable Giving

From 6th April 2011 gifts to charity of 10% of the gross assessable estate (i.e. net of any exemptions and allowances) will reduce the rate charged on IHT from 40% to 36%.

Life Cover

The establishment of whole of life assurance on a last survivor basis can provide sufficient funds to meet the calculated IHT bill. However, this can be expensive, even if underwriting terms are offered.

Use of Trusts - pitfalls

- There is tax at the lifetime chargeable rate of 20% on the value of gifts into a Discretionary Trust if it exceeds the nil rate band as well as 30% of the lifetime chargeable rate i.e. 6% tax on the profits made within the Trust every 10 years.
- Care must be taken to avoid making a gift with reservation, which will effectively negate the intentions of the trust from an IHT mitigation standpoint.
- This was always a specialist area for advice and whilst the additional tax can make the use of most trusts less attractive, they are still very relevant.

There are several schemes that can reduce your IHT liability, which are summarised as follows:

Gift and Loan

This is where the settlor makes a loan to the trust which is then repaid over a period of time. The payments are seen as a return of the loan at a rate of no more than 5%, though it can be less.

If it were to be 5% then the loan is repaid after 20 years, with the option of calling the loan in early if there was a financial need to do so.

Discounted gift scheme

- A monetary gift is made into a discretionary Trust. Once made the gift is deemed to be a "gift without reservation."
- The amount should be below the NRB to avoid the new tax change.
- This means that the Settlor(s) no longer has any right to the capital.
- There is a requirement for income to be taken from the capital.
- The lives of the Settlor(s) are underwritten by the provider and the level of withdrawals determines the immediate discount on the gift, which is deemed to be outside the estate immediately.
- After a period of seven years the whole gift is then outside your estate for IHT purposes although the withdrawals can continue until 100% of the capital has been taken.

Nil Rate Band Planning gifting assets into a Lifetime Trust

This provides that on the death of one married partner, assets are gifted into a trust and held for the benefit of children, grandchildren and/or other beneficiaries.

This could include a proportion of the family home expressed as a proportion of the NRB to ensure the trust uses the full NRB and any growth achieved on the gifted amount post first death is outside the estate.

AIM Listed Shares and IHT

- Whilst these companies need to meet a minimum criteria to receive Business Property Relief (BPR) it does present a very good option for reducing the value of your estate.
- The benefit is that the investment is treated as being outside of your estate after two years.
- The risks associated with investing in AIM markets are higher than primary exchanges.

After the Event Planning – Deed of Variation

- This allows the terms of the Will to be altered after the death of the settlor.
- A Deed of Variation is entered into by the original named beneficiary(ies) and must be done so within two years of the date of death.
- The Deed varies the terms of the Will as though the Will had been drafted to include the new terms amended by the Deed of Variation.

Interest in Possession Trusts

- A monetary gift is made into a discretionary trust. Once made, the gift is deemed to be a "gift without reservation."
- If the gift is into an absolute trust then the usual potentially exempt transfer rules apply and if the settlor survives seven years the original gift will be outside the settlor's estate.
- This means that the settlor(s) no longer has any right to the capital.
- There is a requirement for income to be taken from the capital.
- Trusts which create an interest in possession, where one or more persons benefit absolutely (i.e. without discretion) from the income of the trust, whilst the capital within the trust is for the absolute benefit of one or more other beneficiaries.