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Inheritance Tax

Inheritance tax (IHT) is levied on a person's estate when they die, and certain gifts made during an individual's lifetime.

Most gifts made more than seven years before death will escape tax. Therefore, if you plan in advance, gifts can be made tax-free: the result can be a substantial tax saving.

We give guidance below on some of the main opportunities for minimising the impact of the tax. It is however important for you to seek specific professional advice appropriate to your personal circumstances.

Summary of IHT

Scope of the tax

When a person dies IHT becomes due on their estate. Some lifetime gifts are treated as chargeable transfers but most are ignored providing the donor survives for seven years after the gift.

The rate of tax on death is 40% and 20% on lifetime chargeable transfers. For 2009/10 the first £325,000 is chargeable at 0% and this is known as the nil rate band.

IHT on lifetime gifts

Lifetime gifts fall into one of three categories:

- a transfer to a company or a trust is immediately chargeable
- exempt gifts will be ignored both when they are made and also on the subsequent death of the donor
- any other transfers will be potentially exempt transfers (PETs) and IHT is only due if the donor dies within seven years. It might therefore be more accurate to regard them as potentially chargeable transfers.

IHT on death

The main IHT charge is likely to arise on death. IHT is charged on the value of the estate. This includes any interests in trust property where the deceased had a right to income from, or use of, the property. Furthermore:

- PETs made within seven years become chargeable
- there may be an additional liability because of chargeable transfers made within the previous seven years.

Estate planning

Much estate planning involves making lifetime transfers to utilise exemptions and reliefs or to benefit from a lower rate of tax on lifetime transfers.

However careful consideration needs to be given to other factors. For example a gift that saves IHT may unnecessarily create a capital gains tax (CGT) liability. Furthermore the prospect of saving IHT should not be allowed to jeopardise the financial security of those involved.

Use of PETs

Wherever possible gifts should be made as PETs rather than as chargeable transfers. This is because the gift will be exempt from IHT if the donor survives for seven years.

Nil rate band and seven year cumulation

Chargeable transfers covered by the nil rate band can be made without incurring any IHT liability. Once seven years have elapsed a gift is no longer taken into account in determining IHT on subsequent transfers. Therefore every seven years a full nil rate band will be available to pass assets out of the estate.

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Transferable nil rate band

It is now possible for spouses and civil partners to transfer the nil rate band unused on the first death to the surviving spouse for use on the death of the surviving spouse/partner. On that second death, their estate will be able to use their own nil rate band and in addition the same proportion of a second nil rate band that corresponds to the proportion unused on the first death. This allows the possibility of doubling the nil rate band available on the second death. This arrangement can apply where the second death happens after 9 October 2007 irrespective of the date of the first death.

Annual exemption

£3,000 per annum may be given by an individual without an IHT charge. An annual exemption may be carried forward to the next year but not thereafter.

Gifts between husband and wife

Gifts between husband and wife are generally exempt. It may be desirable to use the spouse exemption to transfer assets to ensure that both spouses can make full use of lifetime exemptions, the nil rate band and PETs.

Small gifts

Gifts to individuals not exceeding £250 in total per tax year per recipient are exempt. The exemption cannot be used to cover part of a larger gift.

Normal expenditure out of income

Gifts which are made out of income which are typical and habitual and do not result in a fall in the standard of living of the donor are exempt. Payments under deed of covenant and the payment of annual premiums on life insurance policies would usually fall within this exemption.

Family maintenance

A gift for family maintenance does not give rise to an IHT charge. This would include the transfer of property made on divorce under a court order, gifts for the education of children or maintenance of a dependent relative.

Wedding presents

Gifts in consideration of marriage are exempt up to £5,000 if made by a parent with lower limits for other donors.

Gifts to charities

Gifts to registered charities are exempt provided that the gift becomes the property of the charity or is held for charitable purposes.

Business property relief (BPR)

When 'business property' is transferred there is a percentage reduction in the value of the transfer. Often this provides full relief. In cases where full relief is available there is little incentive, from a tax point of view, to transfer such assets in lifetime. Additionally no CGT will be payable where the asset is included in the estate on death. However the reliefs may not be so generous in the future and therefore gifts now may be advisable.

Agricultural property relief (APR)

APR is similar to BPR and available on the transfer of agricultural property so long as various conditions are met.

Use of trusts

Trusts can provide an effective means of transferring assets out of an estate whilst still allowing flexibility in the ultimate destination and/or permitting the donor to retain some control over the assets. Provided that the donor does not obtain any benefit or enjoyment from the trust, the property is removed from the estate.

We can advise you on the type of trust which may be suitable for your circumstances.

Life assurance

Life assurance arrangements can be used as a means of removing value from an estate and also as a method of funding IHT liabilities.

A policy can also be arranged to cover IHT due on death. It is particularly useful in providing funds to meet an IHT liability where the assets are not easily realised, eg family company shares.

Wills

As the main IHT liability is likely to arise on death, a sensible and up to date Will is important.

How We Can Help

Whilst some generalisations can be made about IHT planning it is always necessary to tailor the strategy to fit your situation.

Any plan must take account of your circumstances and aspirations. The need to ensure your financial security (and your family's) cannot be ignored. If you propose to make gifts the interaction of IHT with other taxes needs to be considered carefully.

However there can be scope for substantial savings which may be missed unless professional advice is sought as to the appropriate course of action. We would welcome the opportunity to assist you in formulating a strategy suitable for your own requirements.

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