Whitechurch
Financial Consultants
A Division of Whitechurch Securities Ltd

Inheritance Tax
- A Useful Guide

Tax Year ending 5th April 2019

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Introduction

Inheritance tax (IHT) is, essentially, a tax levied on any transfer of assets to other people or trusts. It is mostly paid in respect of an individual's estate on death, but it can also apply in respect of certain transfers of assets during life.

When IHT is levied on the value of an individual's estate after their death it is payable by the executor of a Will (where a Will exists) or by an Administrator in the case of dying intestate (no Will) before assets can be distributed to beneficiaries.

Included in the estate will be certain gifts made within seven years of death or, made at any time, when there is a reservation of benefit which continues within seven years of death.

Each individual who is UK domiciled is allowed an IHT nil rate band which is effectively a value of your estate taxed for IHT purposes at zero per cent. This amount is currently £325,000 and has been frozen at this rate until the 2020/2021 tax year.

Legislation in October 2008 decreed that married couples can inherit any unused part of the first dying partner's nil rate band. Effectively giving married couples a joint nil rate band, currently valued at £650,000. However, this will only be possible if your Wills have been written in such a way that no part of the nil rate band is used upon the first partner's death.

It was announced in the 2015 Budget that the Government will add a 'family home allowance', eventually worth £175,000 per person to the existing £325,000 tax free allowance from 6th April 2017.

This will be worth:

- £100,000 in 2017-18
- £125,000 in 2018-19
- £150,000 in 2019-20
- £175,000 in 2020-21

This will allow individuals to pass on assets worth up to £500,000, including a family home, without paying any IHT at all. For married couples and civil partners, the total will therefore be £1 million. This additional allowance will be gradually withdrawn for estates worth more than £2m.

Inheritance Tax Calculation

Here's an example of what might occur, post 6th April 2017:

Fred and Marjorie were married with three adult children. Their estate is valued at £960,000, including a property of £600,000* and various investments of £360,000. They had mirror Wills that leave everything to each other and then their children equally, but they had not taken steps to reduce their potential IHT liability.

Unfortunately Marjorie passed away in December 2016 and her estate passes to Fred. There is no IHT to pay at this point because transfers on death between spouses are exempt from IHT.

However, on Fred's death the following IHT will be payable:

£960,000 - £650,000 (joint nil rate band) = £310,000

£310,000 - £250,000 (joint family home allowance) = £60,000

£60,000 x 40% death tax = £24,000 IHT

This tax bill would need to be paid before the remainder of the estate, £936,000, is distributed to the children. Marjorie and Fred worked hard and duly paid taxes all their lives. Now, on their death, Her Majesty's Revenue and Customs will receive a further £24,000 from their estate. This guide provides introductory information on how the potential impact of IHT can be managed.

* The family home exemption is currently being phased in from April 2017 to April 2020. As listed opposite, it starts at £100,000 per person, rising to £175,000 per person, as long as certain criteria are met.

How to manage IHT

Growing Problem

Many people do not appreciate that their estate may be subject to IHT. IHT receipts in the 2016/17 tax year have risen by 40% since the 2013/14 tax year (see table below).

2016/17	£4.840 billion
2015/16	£4.673 billion
2014/15	£3.825 billion
2013/14	£3.417 billion

Properties, household savings and to a lesser extent, equities make up the bulk of the estates and hence receipts tend to reflect fluctuations in these assets. Therefore, with property values climbing over recent years and markets recovering from the lows of the recession, many people will now find their estates subject to IHT.

(HMRC National Statistics)

IHT is payable on death if you make a transfer of chargeable property which, after deduction of liabilities, exemptions and tax reliefs, exceeds the nil rate band. You can try the following calculation to give you an indication of whether your estate will face IHT:

Value of all assets – Liabilities	= Estate Value
Estate Value – Available nil rate band (i.e. £325,000 or £650,000) & family home allowance & Exemptions (i.e. £125,000 or £250,000)	= Taxable Estate
Taxable Estate x 40% Death Tax	= IHT due

Under current legislation, IHT is often perceived as a voluntary tax. This is because with careful planning, it is possible to reduce or remove any liability altogether.

Exemptions

Exempt transfers are those which can be made without a tax liability. The most important include:

- Spouse exemption – transfers between UK domicile spouses and registered civil partners whether during life or on death.
- Annual exemption – lifetime transfers of up to £3,000 each tax year are exempt.
- Small gift exemption – outright gifts of up to £250 in any one tax year to any number of people are exempt.
- Normal expenditure out of income – lifetime gifts which are of a regular nature, and made from net income, qualifies for an exemption if they do not affect your normal standard of living.
- Marriage gift exemption – gifts made by certain people in consideration of a marriage or civil partnership taking place are exempt:
    - from a parent £5,000
    - from a grandparent £2,500
    - from others £1,000
- Charities – Gifts and bequests to a UK registered charity or other qualifying body.
- National Benefit – Gifts and bequests to certain national institutions such as the National Gallery or British Museum.
- Political Parties – A transfer of value to a qualifying political party.

Will IHT apply to me?

Tax Relief

Certain assets get relief from IHT. The most important include:

Business property relief – 100% relief is available in respect of a sole trader's business, the interest in a business of a partner, or a shareholding in an unlisted company.

Land, buildings, machinery or plants owned personally by an individual, or a controlling shareholder, qualifies for 50% relief. You can only get relief if the deceased owned the business or asset for at least two years before they died.

Agricultural property relief – 100% relief is available in respect of the agricultural value of land and farm buildings.

Use of Trusts

There are a number of trusts which can be used, the suitability depending on the precise requirements of the individual and the tax consequences of the trust. Some of the reasons for establishing a lifetime trust include:

- The ability to make a gift of assets while maintaining control
- Providing for minor children who are too young to take legal responsibility for gifted assets
- Avoiding or reducing IHT, capital gains tax and income tax
- Providing a flexible environment for the future

Types of Trust

Bare Trust – a bare trust is one which once the beneficiary has been named they cannot be changed and they are absolutely entitled to benefits, both income and capital at the age of 18.

Discretionary Trust – this is a trust where lists of named beneficiaries, or categories of beneficiaries, are entitled to the trust fund. The trustees have the discretion to appoint capital and income to any beneficiary or beneficiaries.

Chargeable Transfers

These are transfers which are neither exempt, nor potentially exempt. The most common chargeable transfers are lifetime gifts into discretionary trusts. A transfer will be chargeable if it (together with transfers made in the previous seven years) exceeds the IHT nil rate band.

Potentially Exempt Transfer (PET)

This is a term which describes gifts of cash and assets which, subject to certain conditions, will not incur a liability to IHT. Gifts between individuals or into bare trust arrangements are termed PETs. A PET made more than seven years before death becomes an exempt transfer. If death occurs within seven years, then the gift becomes taxable, subject to any taper relief and the nil rate band.

Life Assurance

Life assurance plays a major role in either meeting or reducing a prospective IHT liability. Whole of Life Assurance is the oldest established and, arguably, the most effective method of meeting an IHT liability. As the date of death is uncertain, a Whole of Life policy is affected to make sure that capital is available at death to meet the IHT bill. Policies are normally written under a suitable trust arrangement to make sure the policy proceeds do not compromise the deceased's estate upon death.

Pension

With the changes to pension rules that came into effect from 6th April 2015, a pension can also be used to pass on benefits without tax.

Comprehensive Wealth Management

At Whitechurch we know that estate planning and inheritance tax mitigation is a complicated area, and getting it wrong or doing nothing can be very costly. Therefore, if you would like to talk to a financial adviser, please get in touch with us.

We are passionate about helping people who are serious about enhancing their wealth, improving their standard of living and creating a secure long term financial future for themselves and their families.

Our team of experienced, highly qualified advisers deliver a comprehensive wealth management service, built on individually tailored financial planning advice. We also work closely with the award winning Whitechurch Investment Management team to create investment portfolios for clients.

Our ethos underpins our Chartered status which requires us to meet rigorous professionalism and capability criteria and adhere to the Chartered Insurance Institute's Code of Ethics.

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