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Inheritance Tax Myths

- A Useful Guide

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Common misconceptions about Inheritance Tax

Inheritance Tax (IHT) can often be a subject that is sensitive to approach. Let's face it; most people don't like to think about life after they are gone. Because of this, it is an area of financial planning that is often ignored or set aside to think about at another time – sometimes it is then too late.

At Whitechurch, we also come across some misconceptions about Inheritance Tax which stop people from planning and being able to reduce their potential liability.

It doesn't have to be like this. Under current legislation, IHT is perceived as a voluntary tax. This is because with careful planning, it is possible to reduce or remove liability altogether. That's why we have compiled the following to dispel some misconceptions about Inheritance Tax.

"I will gift my money away nearer the time"

It is possible to gift up to £3,000 per year and not have to pay Inheritance Tax on it. You can also gift £5,000 to a child when they get married, grandparents can gift £2,500 and you can gift sums of £250 to as many people as you like. There are also some other scenarios in which you can gift money free of IHT - such as to charities, political parties and museums.

However, you can't simply give away all your wealth shortly before you die and escape IHT. HM Revenue & Customs (HMRC) is wise to such tricks. You have to survive at least seven years after making a gift for its value to fall out of your estate. Until then it is known as a Potentially Exempt Transfer and may fall back into your estate and be liable for IHT if your estate's value exceeds the nil-rate threshold of £325,000 when you die.

"I can now pass on £1m free of tax"

The new limit introduced by the last government came into effect from April 2017. However, the move to raise the IHT allowance to £1,000,000 wasn't quite as straightforward as it seemed. The additional nil-rate allowance applied only if you gifted your home when you die. Also, it started at only £100,000 for the tax year of 2017-18. That's £325,000 + £100,000 = £425,000.

This additional allowance increases by £25,000 in each of the next three tax years until it hits £175,000 in 2020-21.

2018-19	£125,000
2019-20	£150,000
2020-21	£175,000

So in 2020-2021 the personal allowance will be £325,000 + £175,000 = £500,000. But that's still not £1,000,000 each! Only couples who are married or in civil partnerships will be able to combine their personal allowances of £500,000 each to reach the magic number of a £1,000,000 nil-rate allowance.

And that's not the end of the story. Certain criteria will also apply to the property being gifted, your relationship to your chosen beneficiaries and the size of your overall estate.

The reality is that the tax free amount of £1m is neither unequivocally nor immediately available.

"I don't need a Will as my assets will automatically go to my partner when I die"

Many couples think that they don't need to worry about IHT as their partners will inherit everything free of tax. However, without a valid Will in place, under the rules of intestacy, a portion of an estate will go to existing children and this could trigger an Inheritance Tax liability – one that could have been avoided with a Will in place.

"It's too late; it takes 7 years for any gift to leave your estate"

This notion prevents elderly people from considering Inheritance Tax planning. Whilst the seven year period is true, the statement itself does not tell the whole picture.

Gifting into a trust can mitigate tax liability and there are financial planning products that can assure you for the risk of dying prior to the 7 years it takes for a gift to be excluded from your estate.

It is also possible to reduce IHT liability if an asset is gifted three years or more before death. In certain circumstances, gifts made 3 to 7 years before death are taxed on a sliding scale, which is known as 'taper relief'.

Years between gift and death:	Rate of relief
0-3	0%
3-4	20%
4-5	40%
5-6	60%
6-7	80%
More than 7 years	100%

"I don't want to lose control of my money in case I need it"

This is often a major dilemma for people. They either want to try to spend their IHT liability or keep it set aside for future costs.

The issue of losing control of funds can be true, particularly if gifting into an absolute trust, where the beneficiary has instant rights to all the income and capital.

However, there is a type of trust called an Interest in Possession trust where the settlor can be the 'income beneficiary' and is able to receive income payments which could be used for care home costs or perhaps even a holiday or new car – depending on the terms of the trust. At the settlor's death the capital would then go to the 'capital beneficiary.'

Interest In Possession
Settlor places capital sum in this trust.

Settlor is the 'income beneficiary' and receives income from the capital.

Under normal 7 year rule, the capital sum, reduces IHT liability and goes to the 'capital beneficiary.'

"I am too young to begin planning for my children's inheritance, I've only just retired!"

You have only just entered the life stage of retirement, you're planning how to take benefits from the money you have saved your whole working life. The last thing you want to think about right now is giving it away!

However, there are advantages of planning Inheritance Tax mitigation earlier on. For a start, you are more likely to live longer so you can fully benefit from the 7 Year Rule for gifts.

Lifetime gifting is an established means of mitigating IHT. Other than Exempt Transfers or Potentially Exempt Transfers, you can also make use of a Chargeable Lifetime Transfer. However, with this type of gift it is possible to be caught out by the lesser-known 14 Year Rule! Hence, it is another reason to start your IHT planning mitigation sooner rather than later.

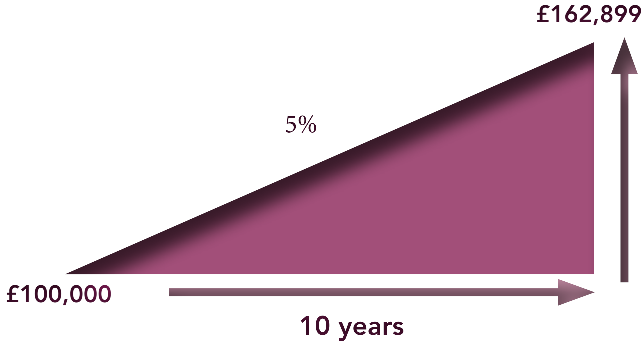
It is also possible to cover your IHT liability with a life assurance policy that pays out to your beneficiaries on your death. The premiums are more manageable when the policy is started earlier in life.

"ISAs are the most tax efficient form of investing!"

The more accurate statement would be: "ISAs are one of the most tax efficient forms of investing!" An ISA may not be the best option if there is a sizeable amount of other assets. This is because of the impact that Inheritance Tax would have on a deceased person's ISA. The impact of IHT could reduce the value of the estate to less than the outcome of an alternative investment strategy. Take a look at the two following scenarios.

Scenario 1:

A transferred ISA with a value of £100,000, plus growth achieved over 10 years - based on a 5% pa growth rate.

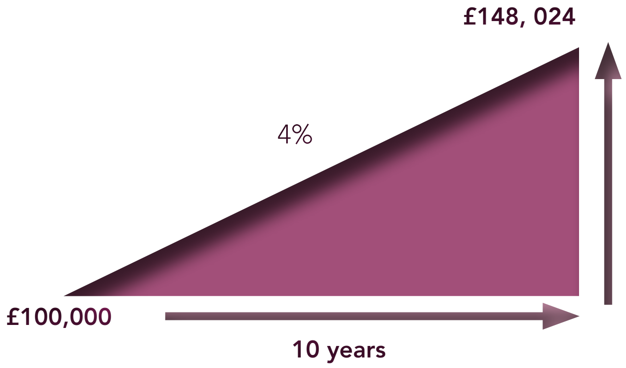


In this scenario, over 10 years the ISA builds up to £162,899. However, ISAs are not exempt from Inheritance Tax. As such, after this person dies their nil rate allowance will be used up by other assets and the value of the ISA will be reduced by IHT.

£162,899 x 40% IHT = £65,160 Inheritance Tax liability
This means that after 10 years of growth, the value of the ISA is now £97,739.

Scenario 2:

An inheritance tax-efficient investment – written into trust. Starting value of £100,000 plus growth achieved over 10 years – based on 4% pa growth (5% less 20% internal tax):



In this scenario, over 10 years the investment builds up to £148,024. However, because it is in an IHT tax efficient investment, when this person dies there is no IHT to pay so the investment remains at £148,024 for the beneficiary.

This is a potential saving of £50,285 due to using an IHT efficient solution instead of an ISA.

There is no time like the present!

The solutions for reducing Inheritance Tax liability will vary. Concerns may be addressed by one of the scenarios mentioned here or a mix of solutions may be required.

It is important to obtain professional and specific advice. Ultimately, we want to make sure that everyone starts to think about their Inheritance Tax liability as it will almost certainly be the biggest bill levied on any estate.

If you would like to receive more information about Inheritance Tax please get in touch. You can, email us at wfc@whitechurch.co.uk or call us on 0117 916 6194.

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