



Inheritance Tax: Some background

When is Inheritance Tax paid?

The fundamental principle of Inheritance Tax is that when somebody dies all the property which they own (their personal chattels, their house, their cash savings and investments), or which they have given away in the previous seven years, will be valued and added up and from the total the excess over £325,000 ("the Nil Rate Band") is taxed at 40%. There are a number of reliefs but the main exceptions from liability can be summarised as follows:

- All property which passes to a spouse/civil partner or to a Charity is exempt from Tax regardless of value.
- Some assets are exempt and will not be included in any tax calculation; typically business assets, agricultural property or woodlands.
- Lifetime gifts more than seven years old will still be taken into account if the donor retained some interest or benefit in the property which was given away.
- Certain lifetime gifts are automatically exempt and here the main ones are:
 - a gift or gifts to any number of individuals of less than £250 each in each tax year;
 - a gift or gifts totalling in aggregate no more than £3,000 in value per tax year;
 - gifts in consideration of marriage of up to £5,000 if made by a parent or £2,500 if made by certain other relatives or up to £1,000 if made by anybody else;
 - and gifts which can be regarded as normal expenditure out of income.

So how can money or property be given away without incurring a tax bill?

It follows from what has been said above that you can give away any amount you want to, provided first that there are no strings attached and second that you survive seven years. However, there is the over-riding consideration of affordability both for your present and future needs and this is against a background where health and long-term care expenses in later life are becoming ever more expensive. It should be part of your philosophy that the tax tail should not wag the practical dog.

A popular solution is to write a Whole Life policy into Trust for children or grandchildren with a single premium being paid and survived by seven years or with quarterly or annual premiums being paid out of income; the policy proceeds would then be outside your Estate for tax purposes.

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A private residence carrying a substantial value but not producing any income is often a target for tax planners.

You cannot give the house away as in an Inheritance Tax saving exercise and continue to live there unless you pay a commercial rent which is an expensive option. An effective way of passing the capital value in the house while not compromising your right to live there rent-free, which is the tax planner's equivalent of having cake and eating it, would be to enter into an Equity Release and to give the realised capital away. You still need to survive seven years. There is still the question of affordability, because once the capital has been given away it is gone for ever. The terms of any Equity Release will also need to be considered most carefully, and proper financial and legal advice is essential.

It is expensive to give away a house and rent it back, but it can be surprisingly cheap to give away valuable chattels and to rent them back.

You can retain some control over funds you give away to, say, your grandchildren, by putting the amounts involved into a lifetime settlement for them.

You can use the annual exemption of £3,000 per annum to build up the value of the Trust over a period of time. You can otherwise put as much as you want into the Trust up to the limit of the Nil Rate Tax Band with no tax consequences providing you survive the gift by seven years.

What about my Will?

In this context it is useful to consider a typical family situation of a married couple with children and perhaps grandchildren. When one spouse/civil partner dies, and the survivor inherits all his or her estate, then the deceased's Nil Rate Tax Band (£325,000) is transferred to the survivor. Accordingly, when the survivor dies he or she will have the benefit of both Nil Rate Tax Bands thereby effectively doubling the allowance; £650,000 in the present tax year.

There are one or two exceptions to this. The Nil Rate Tax Band which is carried forward in this way will suffer a pro-rata reduction if the first spouse/civil partner to die used his or her Nil Rate Tax Band in whole or in part. This might be because of legacies which the first spouse/civil partner left to, for example, his or her children, or because of lifetime gifts which are not exempt and which have not fallen out of account because they are less than seven years old or there was a retained benefit.

There is now a tax break for homeowners who leave their private residence in their Will to a direct descendant. This takes the form of an addition to the Nil Rate Band and is called the Residence Nil Rate Band. It is worth £100,000 in the tax year 2017/18 and will increase by £25,000 each year until in 2020/21, the relief will be worth £175,000. The relief is transferrable between spouses and civil partners, and so in 2020/21 could be worth £350,000 to the benefit of the survivor's estate. By claiming this, the tax saving could be as much as £140,000. The rules accompanying this relief are, however, very complex and professional advice is recommended.

It is possible within two years of someone passing away for the beneficiaries of the Will (or, where there is no Will, of the intestacy) to join together and by mutual agreement enter into a Deed which varies the terms of the Will (or intestacy) and that variation will be perfectly effective for all tax purposes. This is tax planning with the benefit of hindsight; a very useful tool indeed.

Inheritance Tax is a vast and complex subject area and these notes are necessarily very general and are not designed to provide anything more than a glimpse and an over-view. At Mander Hadley we will give you specific tax advice tailored to your individual circumstances.

It will be appreciated that tax planning advice and mitigation, is complicated and a specialist activity. Our professional fees for this work will therefore be quoted to you on an individual basis at the time we receive instructions from you.

Find out how Mander Hadley can help you

Although helpful, the brief information included in this document is intended as a guide only and does not constitute legal advice. For more detailed information regarding any of the matters raised in this guide, tailored to suit your specific circumstances, please contact a member of Mander Hadley's Wills, Probate and Older Client Services team.

