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ADVISING FAMILIES ACROSS GENERATIONS

Inheritance Tax (IHT) planning and your family home

For the majority of people, the family home is their most valuable asset and, through house price inflation alone, more people than ever will be subject to IHT. Whilst there are ways to mitigate it, taking the value of one's home out of this trap is far from easy and, for most of us, all but impossible.

If you are married or in a civil partnership things are a bit easier, in that at present there is no IHT between spouses or civil partners. If, however, you're not married etc., then the situation is very different, in that regardless of whether you have a Will or not if the value of the property exceeds the tax free Nil Rate Band (NRB) which currently stands at £325,000, the balance will be taxed at 40%. That means on a property valued at, say, £650,000, the estate would have to pay out £130,000 in tax. If the only asset is the house, then where will the money come from?

Whilst it's possible to give your property away during your lifetime, there are eight things to watch out for:

1. Chargeable Lifetime Transfers

If you are gifting the property to Trust, this is treated as something known as a Chargeable Lifetime Transfer (CLT). If you made gifts of more than £325,000 in any 7 year period to Trust, they will attract an immediate 20% tax, plus will be subject to periodic and exit charges. This could still work out less than the 40% charge upon death but will need careful consideration.

2. Potentially Exempt Transfers

Even if you gift the property to an individual, it will still be classed as what is known as a Potentially Exempt Transfer (PET). This means that although there will be no immediate tax charge, if you die within 7 years of the gift, it may still be included in your taxable estate for IHT calculations on death. The taxation due on this gift will be tapered down as time passes in the following way:

Period of years before death	% reduction (tapering relief)
0-3 years	Nil
3-4 years	20%
4-5 years	40%
5-6 years	60%
6-7 years	80%
More than seven years	No IHT

3. Gifts with Reservation

If you continue to live in the property and don't pay a market rent, then it's what's called a Gift with Reservation of Benefit (GROB) and, for IHT purposes, the gift is treated as still being in your estate.

4. Capital Gains Tax

If the person you gift the property to doesn't live in the property, then they will be subject to Capital Gains Tax on the sale.

5. Generational Inheritance Tax

Unless you gift the property to Trust, it will add to the estate of the recipient and may cause them an Inheritance Tax problem themselves.

6. Income Tax

If you continue to live in the property but pay market rent, then the new owner will also have an income tax liability for the rent you are giving them.

7. **Loss of Power**
By giving away the property you lose your security, in that you'll be exposed to whatever happens to the new owners, such as the property having to be sold if they get into debt, suffer a bankruptcy or get divorced etc..

8. **Pre-Owned Assets Tax**
If the gift is not what is known as being at 'arm's length', i.e. the recipient is wholly unconnected such as an equity release provider, it may be subject to Pre-Owned Assets Tax (POAT).

It's not all doom and gloom though, in that it is possible to give a share in the property to someone else (an adult child say) and who shares the running costs of the home. This must be a permanent arrangement, and you will need to provide HMRC with evidence proving that the other person is also responsible for their share of the maintenance costs. If that is not the case, or if the other person moves out at a later date, then the value of the property will be added to your estate once again.

Trying to remove one's home from the IHT trap is difficult, fraught with dangers and not something one should lightly do. That said, for some people it does represent a legitimate IHT mitigation strategy but be very careful before acting.

Residence Nil Rate Band

Whilst the NRB has been frozen at £325,000 until 2021, individuals now have the opportunity to also claim an additional RNRB – with strings attached. This started to be tapered in in April 2017, and will not fully apply until 2020. Today, an individual could claim an additional £125,000 (rising by £25,000 in April 2019 and April 2020 to reach £175,000) against their main residence, but only if the property/money from the sale of it is going to 'direct' heirs, i.e. children, stepchildren, adopted and foster children.

That said, once the estate value reaches £2m the relief starts to taper off. For a married couple, by the time the estate is £2.7 million, this RNRB has disappeared altogether. In the event the house has been sold before the death, you may still be able to claim the RNRB due to the down-sizing provisions.

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