Inheritance Tax

It was Julius Caesar who first implemented Inheritance Tax (IHT). However, it wasn't until 1796 that 'death taxes' were introduced to the U.K. to finance the war against Napoleon Bonaparte. Death Duties, as we know them, were introduced in 1894 as a way to breaking up large estates as part of a politically motivated way of curbing the influence of the landed gentry. Since then, the law of unintended consequences and rampant house price inflation means that an increasing number of us are subject to IHT. In fact, according to figures just released by HMRC, last year the Treasury collected £3.4 billion in Inheritance Tax (IHT), that's a £1 billion increase since 2009.

As with many taxes introduced in war time the law never changed, and we have been subject to some form of tax on death ever since, which some might say is especially harsh as one can hardly avoid dying. In many ways IHT is the most unfair of taxes; in that, we pay tax on everything we earn, we pay tax on everything we save, we pay tax on everything we spend and then our heirs have to pay even more tax on what's ever left when we die! That said, there are ways in which you can reduce or even completely remove the need to pay it.

Each us is allowed to give away free of IHT an amount equivalent to what is called the Nil Rate Band (NRB), which currently stands at £325,000. Apart from certain exempt gifts (see below) everything above the NRB is taxed at 40%. One thing to remember is that in calculating how much tax is payable, Her Majesty's Revenue & Customs (HMRC) will take into account everything you own including your family home.

So what are the major exemptions?

Gifts between spouses or civil partners are completely free of IHT, unless that is you're domiciled outside of the U.K. wherein different rules apply. Being married or in a civil partnership currently allows you to double the NRB to £650,000 upon the death of the survivor, but the law can be changed at any time and this concession could be reduced or even removed.

Gifts to U.K. charities, institutions such as the National Trust, certain types of heritage property, land to registered housing associations or to established political parties are free of IHT, as are lump sums paid from pension schemes, refunds of personal pension contributions, or on the estate of someone killed on active service.

You can also make tax free gifts during your lifetime such as any number of small gifts of £250 each, regular gifts out of income (as long as your lifestyle remains unaffected), gifts on your children's or grandchildren's marriage (£5,000 from each parent of the bride and groom, and £2,500 from each grandparent), gifts for maintenance of family such an ex husband, wife or civil partner, children under 18 or still in full time education and up to £3,000 in total per year of other gifts which can be carried forward one year if unused.

In addition, you can also make regular gifts or payments not including your capital from your after-tax income and that are part of your normal expenditure. These gifts are usually exempt from Inheritance Tax only if you have enough income left after making them to maintain your normal lifestyle.

These gifts include: -

- monthly or other regular payments to someone
- regular gifts for Christmas and birthdays, or wedding/civil partnership anniversaries
- regular premiums on a life insurance policy - for you or someone else

You can also make exempt maintenance payments to: -

- your husband, wife or civil partner
- your ex-spouse or former civil partner
- relatives who are dependent on you because of old age or infirmity
- your children, including adopted children and step-children, who are under 18 or in full-time education

It will help your executor or personal representative to sort out your financial affairs when you die if you keep a record of any gifts you make and note on that record which exemption you've used. It's also a good idea to keep a record of your after-tax income if you make regular gifts out of income as part of your normal expenditure. This will show that the gifts are regular and that you have enough income to cover them and your usual day-to-day expenditure without having to draw on your capital.

If you own a trading business and have held the shares for at least two years, then 100% Business Property Relief (BPR) applies. You won't however benefit from BPR if the business is wholly or mainly involved in investment activities such as owning Buy-to-Let property. If you're involved in agriculture, then Agricultural Property Relief (APR) applies. However, without a properly drafted Shareholders' or Partnership Agreement and the concomitant Cross-Option Agreement, you may loose BPR entirely.

In a not dissimilar vein, certain types of commercially available investments are available, of which some become IHT free after only two years.

<u>Who pays Inheritance Tax and when?</u>
Where an estate is liable to Inheritance Tax, it must be paid before Probate is granted, i.e. before the Will is officially recognised. That means that any IHT liability must be agreed and paid within six months of the end of the month in which death occurred, after which interest will usually be added, before any assets are distributed to the beneficiaries.

<u>What if my beneficiaries do not have enough cash to pay the IHT bill?</u>
Assets cannot usually be distributed until the IHT bill has been settled. However, but solely at HMRC's discretion, liabilities based on the deceased person's home and any other land or buildings in the estate may be paid by instalments over 10 years. HMRC is a preferential creditor and has the right to be paid first, thus assets such as the family home may have to be sold to meet the tax bill.

<u>Can I give my home to my children and continue to live there to reduce my IHT bill?</u>
Unless you're paying a market rent to remain there as a tenant, HMRC will regard this as what is known as a 'gift with reservation of benefit', and thus disregard the transfer when calculating the IHT bill. As a general rule, gifts with strings attached are treated as if they had not happened and you should be very wary of complex trust-based schemes that purport to take the family home outside of the IHT trap without requiring you to pay a market rent whilst allowing you to continue living there. Even if you are paying a market rent, there may still be a liability to both income and capital gains tax. Moreover, if your children divorced or got into financial difficulties, then your 'home' may have to be sold. Lastly, the same rules apply to any asset that you give away and continue to enjoy a benefit from.

There is the much vaunted increase in the NRB to include up to £350,000 from the value of one's main residence, which will not fully apply until 2020 and only then if the money's going to 'direct' heirs, i.e. children, stepchildren, adopted and foster children, and grandchildren and the estate includes a family home worth at least £350,000. That said, once the property value reaches £1m the relief starts to taper off and disappears altogether if it's worth £2.7m or more. Likewise, neither the Treasury nor HMRC seem to know how the additional tax free amounts will come in to play if the deceased's main residence was sold some time before death and the proceeds either spent or invested elsewhere. Meanwhile, based on current industry understanding, the trust clauses used to create and protect a tenancy in common give sufficient scope to at least allow the direct descendant criterion to be fulfilled.

<u>Do gifts made during my life suffer from IHT?</u>
The short answer is Yes. IHT extends to include gifts made within seven years of your death, and will only be exempt if you lives for seven years after making them. If you die before that, the value is added back into the estate. However, if the total value of the gifts is greater than the NRB, the IHT on the portion above the NRB will be reduced by something called Taper Relief as shown below.

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

This fact sheet is based on our understanding of current taxation, legislation and HM Revenue & Customs practice as at September 2015, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) will depend upon your individual circumstances.

Planned Succession Limited - Suite 6, 43 Bedford Street, London WC2E 9HA.

Switchboard : - 0203 303 0963

Email: - info@planned-succession.com

Web: - www.planned-succession.com