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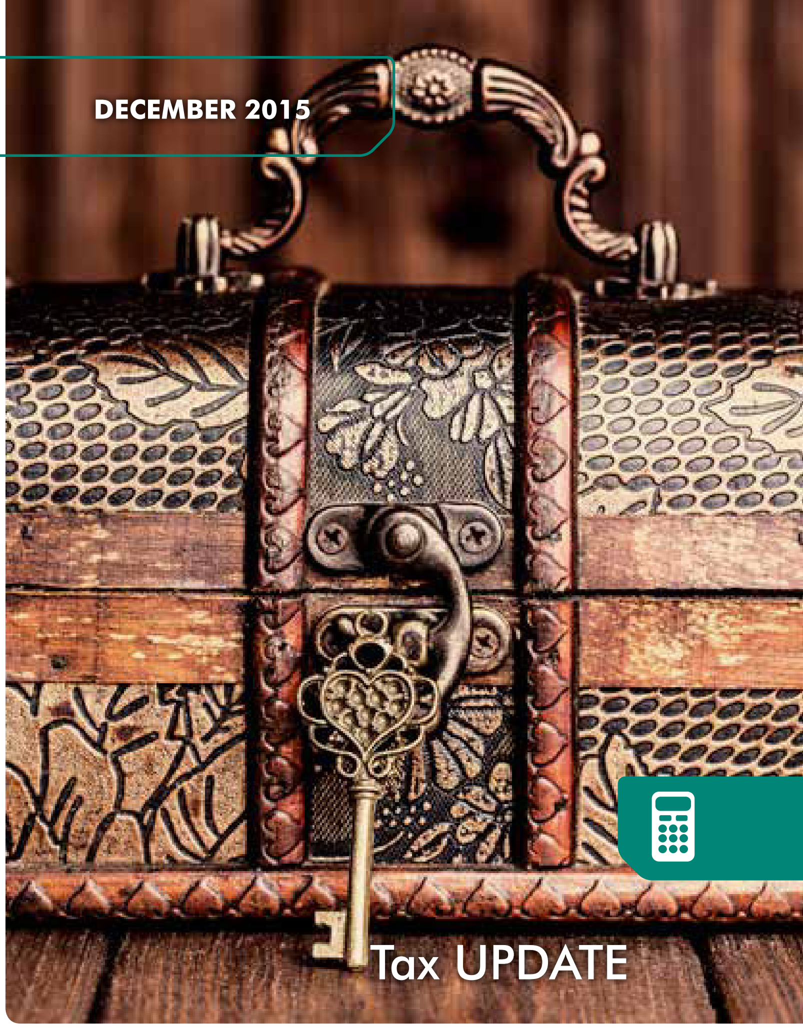

Minimising inheritance tax

A guide to changes to the inheritance tax nil-rate band and strategies to reduce your liability.

We all like to think that our nearest and dearest will lament our passing with fond memories. It would be sad to think that after the initial period of mourning has passed, kind words turn to bewilderment when your beneficiaries realise your estate has a large inheritance tax (IHT) bill?

It has often been said that IHT is a voluntary tax. To some extent this is true. So why would anyone voluntarily make their grieving relatives pay hundreds if not hundreds of thousands of pounds to HMRC when some simple planning means they can reduce or even eliminate their IHT bill?

Before you dismiss the idea that it won't affect your estate,

analysis carried out by Prudential showed that:

- the amount of money paid in IHT rose 15% in 2012/13
- the average IHT bill was more than £170,000
- the average bill in London was almost £236,000
- just under 18,000 families paid £3.05 billion, which represented the largest numbers recorded since 2008.

As these figures are 2 years old, the rise in the stock market and even more substantial increases of house prices in many parts of the country could mean that more and more people could find that IHT is due on their estate when they die.

Now that IHT is no longer something which only affects the very wealthy, it is has become a real worry to many clients. Here is a brief guide to the position now, and the changes that are to come.

The nil-rate band

IHT is currently levied at a rate of 40% on the value of an estate above the tax-free threshold of £325,000 per person. Married couples and civil partners can effectively double the allowance, passing on assets worth up to £650,000.
From 6 April 2017, the government will add a 'family home allowance' of £100,000 per person. This will allow individuals to pass on assets including a family home worth up to £425,000 to direct descendants. As under the current rules married couples and civil partners will be able combine their allowances.

The family home allowance will increase by £25,000 each year until it reaches £175,000 in 2020. At that time individuals could pass on assets worth up to £500,000 including a home without incurring any IHT. For married couples and civil partners, the combined total is £1 million.

Speak to us about how changes to IHT may affect you.

Strategies to minimise IHT liability

Fortunately there are ways to minimise the proportion of your estate that is liable for IHT.

Gifts to charities

It's possible to reduce your IHT rate from 40% to 36% by giving at least 10% of the net value of your estate to charity. The donation is not liable for IHT and is not included in the taxable value of your estate. It is this gross value which is taxed at 36%.

Minimising inheritance tax

In most cases, a 10% charity donation will reduce the amount non-charity beneficiaries receive. However, it will also mean a reduction in the amount of IHT due, compared to not making any charity donation.

The following example compares a 0% and 10% charity donation on an estate worth £500,000.

% of estate given to charity	0%	10%
Estate value	£500,000	£500,000
Amount exceeding nil-rate band	£125,000	£125,000
Gift to charity	£0	£12,500
Taxable estate	£125,000	£112,500
IHT	40% x £125,000 = £50,000	36% x £112,500 = £40,500
Amount available other beneficiaries	£75,000	£72,000

Wedding gifts

Wedding gifts/civil partnership ceremony gifts:

- parents can each give cash or gifts worth £5,000
- grandparents and great grandparents can each give cash or gifts worth £2,500
- anyone else can give cash or gifts worth £1,000.

You have to make the gift on or shortly before the date of the wedding or civil partnership ceremony. If the ceremony is called off, this exemption won't apply.

Regular gifts or payments that are part of your normal expenditure

Any regular gifts you make out of your after-tax income, not including your capital, qualify as exempt from IHT, as long as you have enough income left after making them to maintain your normal lifestyle.

These include:

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

Small gifts

You can make small gifts up to the value of £250 to as many individuals as you like in any tax year.

Tax-free gifts

- up to £3,000 worth of gifts given away by the deceased in each tax year
- payments to help with living costs for example to an ex-husband, ex-wife or former civil partner, a relative who's dependent on you because of old age, illness or disability or a child under 18 years old or in full-time education
- gifts to charities, museums, universities or community amateur sports clubs
- gifts to political parties that have either 2 members elected to the House of Commons or 1 member elected to the House of Commons who received at least 150,000 votes in a general election.

Other reliefs are available including include business relief, agricultural relief and woodland relief.

In addition, there is a death in service exemption available to members of certain occupations. The estate doesn't have to pay IHT if a person was helping in an emergency that caused or contributed to their death and was a:

- member of the armed forces
- member of the emergency services
- humanitarian aid worker.

Potentially tax-free gifts

Most gifts you make to other people during your lifetime are classified as potentially exempt transfers (PETs). If you survive for 7 years after making the gift, no IHT is due. If you die within this time the following applies:

1. The PET is reassessed. It will be added to any other taxable gifts you may have made in the 7 years before making the PET. This effectively means that gifts made during the 14 years before death could become relevant.

If tax does become due on a PET, the person who received the PET has to pay the tax.

2. The PET is added to your estate. This is to work out how much tax is due on the estate as if much of the tax-free allowance has been used up against PETs and taxable lifetime gifts, this can leave little or no allowance to be used against the rest of the estate.

Get in touch to find out more about IHT.