



INHERITANCE TAX

Inheritance tax is payable on total assets held at the time of a person's death. The first £325,000.00 (known as the nil rate band and figures based on tax-year 2009-10) passing at that time will not give rise to a liability but when it exceeds this figure there will be a liability to tax on the excess at a flat rate of 40%. For married couples or civil partnerships this is aggregated so on the death of the last survivor the nil rate band is doubled, effectively £650,000 for tax-year 2009/10.

Example

"In 2002 Mr. & Mrs. Smith had an estate worth £900,000. In 2006 Mr. Smith died leaving his total estate now worth £1.2m to his Wife. Due to the inter spouse exemption no inheritance tax is payable on assets left to the surviving spouse. Shortly after, in July 2007, Mrs. Smith died leaving her total estate worth £1.3m to her son John.

To calculate the amount of tax that John would have to pay we simply deduct the current nil rate band of £325,000 plus an allowance of £325,000 for Mr. Smith from the estate value leaving a taxable estate amounting to £650,000 (£1,300,000 - £650,000). This is then taxed at a flat 40%, resulting in a potential bill of £260,000".

Mr. & Mrs. Smith could have considered a number of options to mitigate their estate's liability to inheritance tax.

Listed briefly below are the most favoured options. These are explored in more detail within more comprehensive guides that are available on request or within the website.

1. Spend! This is often overlooked but can be a very effective means of reducing a liability. It is also the most enjoyable method. Having said that, in practice it is very difficult to achieve as it invariably involves changing the spending habits of a lifetime and should you need your capital to generate income, then this can be impracticable.
2. Make Gifts. Consider gifting capital to your beneficiaries now. Whilst you would lose access to the capital should you survive seven years after the gift is made this will then be outside of your estate for tax purposes. The main reason for not gifting is to ensure that you retain access to the capital to cover unforeseen expenses or to generate income.
3. Gifts into Trust (or Beating the Tax). Consideration may also be given to gifting capital into trust. A reasonable sum would need to be invested to achieve the tax saving required, although any amount is infinitely better than nothing. If there is a need (income, access to capital) from any capital placed in trust, there are a few schemes worthy of consideration and one of these is to set up a Loan Trust.





With this type of scheme, a capital sum would be invested into a single premium investment bond that is then placed into the trust. With immediate effect, ALL growth is outside your estate with the original capital invested remaining inside your estate. This has the effect of freezing the taxable value the gift although if you elected to take an income, this would be reduced each year by the level of income received. This should be more than replaced by the actual growth of the bond itself. This is a fairly simple yet effective method of reducing the tax liability whilst enjoying an income. As an alternative to the Loan Trust or to compliment it, a Discounted Gift Scheme could be considered. With this type of plan, again a lump sum is invested that is written in trust. Then, depending upon your age, sex and health, the Capital Taxes Office deem that a proportion of the capital invested to be outside an estate immediately with the balance outside after seven years, so in effect, we may achieve both an instant and a future tax saving. This plan does not allow access to the capital but a regular income is payable.

4. Transfer monies into an investment portfolio that invests within the Alternative Investment Market (AIM), which qualifies for Business Property Relief and will mean funds once held for at least two years will be exempt from Inheritance Tax.

5. Wrap existing life assurance and death-in-service plans in a trust. There are two ways that this may be achieved. If feel that your spouse (if applicable) can managed without a life assurance payment then the benefits may be simply wrapped in trust for children or selected beneficiaries thus avoiding liability to inheritance tax. Should the surviving spouse wish to have control and potential access to the benefit gifted into a trust then consideration could be given to a pilot discretionary trust. Independent legal advice should be sought in relation to this area

6. Insure the Liability (or Meeting the Tax). Probably the simplest way of making provision for the tax, this involves taking out a life assurance plan to pay out a capital sum on your death to pay some or all of the tax. The big advantage of this type of plan is that the full benefit is outside the estate from day one with no seven-year wait once the plan is written in trust. The main disadvantage is that a monthly or annual premium is payable to secure the benefits. Whilst this plan will meet rather than beat the tax, it cannot be ignored, especially if you are willing and able to pay the premiums.

In conclusion, there are a variety of methods we can employ to mitigate an inheritance tax liability and it may be that we shall need to consider some of the above plans to achieve this. Choosing the most appropriate method is difficult and will depend upon your own needs and wishes.

Inheritance tax planning is a very complex area and one that involves individual advice and assistance. This guide is designed to provide you with a preliminary understanding of the issued involved prior to a one-to one consultation.

Please note that the Financial Services Authority does not regulate all of the matters covered above.

For further information please call 0845 0551970 or go to www.henwoodcourt.com

