

NHFA Infosheet 9

Inheritance Tax (IHT)

Many people believe that Inheritance Tax is only for the rich. It is true that no liability arises if the Estate on death is less than the nil-rate band (£275,000 in 2005-2006) or where the Estate is left to all exempt beneficiaries such as a surviving spouse or a charity.

However, it is predicted that around two million households could face the prospect of an Inheritance Tax liability within the next ten years.

IHT is levied at 40% on all assets over the nil-rate band.

Who pays IHT?

Anyone domiciled or deemed domiciled in the UK. IHT is levied on worldwide assets. Non-domiciled individuals will be taxed on their UK assets only.

Domicile

It is considered that you are domiciled in the country where you have your permanent home. Domicile is not the same as nationality or residence. You can only have one domicile at a given time. Rules for determining domicile can be complex, especially for married people of different domicile.

Minimising or avoiding IHT

Fortunately there are ways of reducing the potential liability for Inheritance Tax. The most effective ways would normally require forward planning.

Gifts

Lifetime Gifts

Gifts can be given during one's lifetime. If they are not exempt, they are referred to as Potentially Exempt Transfers (PETs) as they leave your Estate for IHT purposes if you live for seven years after the gift. Taper relief is available for transfers made more than 3 years before the date of death

provided the gift would be all or partly subject to IHT. For a gift to be effective the donor must not be seen to have reserved a benefit (gifts with reservation).

Tax Free Gifts

Transfers between spouses. Donations to UK charities, political parties or certain national institutions.

Annual Exempt Gifts

Annual gift of up to £3,000 to anyone. If you miss making the £3,000 gift last year, you could gift £6,000 this year. Husbands and wives each have their own allowances.

Small gifts of up to £250 per person.

Normal expenditure out of income.

There is no limit on how much can be given as long as the gifts meet three conditions. First, it must be paid out of income not capital. Second, the gift must not affect your normal standard of living. Third, the gifts must be regular at least once a year. The Revenue may require evidence that you meet these conditions.

Marriage gifts. You can give up to £5,000 to your own child on marriage, grandparents can give £2,500 to a grandchild and £1,000 can be given by anyone else. The gift must be conditional on the marriage actually taking place.

Maintenance gifts spent on education or training your children under age 18 and in full time education. Also reasonable amounts to support dependent relatives are exempt.

Reliefs

Business assets

If you are a partner in a business or a sole trader no Inheritance Tax would normally be payable if you give away your interest. This may not apply to cash held in a

business. Controlling interest in an unincorporated business, or a share in a partnership, or a shareholding in unlisted companies such as those quoted on the Alternative Investment Market attract 100% relief, provided that you have held the shares for at least two years. 50% relief can be obtained on land or equipment which is used for a qualifying business. Qualifying businesses are those carried on for profit, ones which deal mainly in securities, land or buildings do not normally qualify.

Agricultural land

This may also attract 100% or 50% relief. Owning woodlands can effectively postpone paying IHT until the timber is cut or sold. (Woodland Relief)

Armed Forces

With regards to servicemen or women who die as a result of a wound inflicted, illness contracted or accident that occurred on active service are exempt from IHT, even if the death does not occur immediately.

Pensions

Company and Occupational pensions often provide death-in-service benefits of up to four times your annual salary. On death before taking the benefits the money would normally be passed to the member's spouse, thus increasing his or her potential liability for IHT.

The pension Trustees could pay out to others, say his or her children, if the member informs the Trustees of his or her wishes. A discretionary or flexible trust could receive the money with the surviving spouse being only one of the beneficiaries.

The same kind of procedure can be used to exclude your pension fund from your Estate for personal stakeholder pensions.

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Life Assurance Policies

Term assurance can be purchased to cover Potentially Exempt Transfers against the event of the donor dying within seven years of the gift. A seven-year term assurance policy in trust would provide funds to pay the tax bill on death. Whole of life policies in trust can be used to cover all or part of the tax liability on death.

Annuities can be used to provide incomes to pay for whole of life policies in Trust. The purchase price of the annuity would leave your Estate immediately. The sum assured of the whole of life policy is outside your Estate as it is in trust. Should you buy a Long-Term Care, Immediate Care Plan for a single premium, this will leave your Estate immediately.

Trusts and Wills

A Trust is set up by someone (the Settlor) gifting assets to Trustees who now legally own the assets and which they hold on behalf of persons who the Settlor wants to benefit (the Beneficiaries). The Trustees must always act in the best interests of the Beneficiaries and are controlled by the terms of the Trust.

There are several classes of Trust, each class being taxed differently.

Trusts offer the opportunity to reduce the potential liability to Inheritance Tax. They can be created during your lifetime or on death using your Will.

There are a number of advantages in using Trusts. A Trust could do some or all of the following for you:

Any increase in capital within the Trust would be outside your Estate for IHT purposes provided that you (the Settlor) are specifically excluded from benefiting from the Trust.

Some Trusts allow the Settlor to enjoy an income from the Trust.

After seven years all the original investments into the Trust could be outside your Estate for IHT purposes.

Some Trusts have the effect of removing some capital immediately from the Settlor's Estate.

Trust assets can be paid out to the Trustees before Probate is granted.

Foreigners owning offshore assets can set up Trusts to protect them from being liable to IHT.

Through a Trust you can control who receives the capital and income and when it is received.

Trusts are often regarded as being more certain than Wills if the Trustees are chosen carefully, as Wills are more likely to be challenged or could be changed by using a Deed of Variation.

Pre-owned assets tax (POAT) can create income tax liabilities for people setting up trusts to avoid IHT. Action can be taken to reduce this tax.

Wills

It is advisable for each individual to make a Will in order to utilise their nil-rate band effectively. For married couples, it is worth considering bequeathing up to the nil-rate band to children/grandchildren rather than to each other. This can have a potential tax saving of £105,200.

Deed of Variation

Currently it is possible to alter Wills after death by means of a Deed of Variation. This can be used for IHT purposes. For example, a parent inheriting assets might wish them to go to the children directly or a rich son might want his less well-off sister to have his inheritance. The Deed

can work even if someone dies without having made a Will (Intestate).

The Deed has to be effected within two years of death. If the Deed is done for tax purposes the Inland Revenue Capital Taxes Office must be informed within six months of the Deed being set up. You cannot always set up a Deed of Variation and it may be that legislation may restrict the use of Deeds of Variation in the future.

Gifting your Home

This will not work for IHT purposes, if you continue to live there as it would be regarded as a 'gift with reservation'. However Equity Release Schemes could offer scope to reduce the IHT problem.

Other Matters

Each individual has his or her nil-rate band allowance. Thus between them a husband and wife could enjoy two nil-rate bands, currently a total of £550,000, with careful planning.

You do not pay Capital Gains on your assets when you die.

How much tax?

Estate	Tax
£275,000	nil
£300,000	£ 10,000
£400,000	£ 50,000
£500,000	£ 90,000
£750,000	£190,000
£1,000,000	£290,000
£2,000,000	£690,000

The information contained within this infosheet is based on our understanding of current tax legislation, which may change in the future. No responsibility can be accepted for action taken based on this information. NHFA, April, 2005
To estimate your potential liability to inheritance tax use the attached table.

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How much am I worth? If you would like us to provide advice on your particular circumstances please complete this form and return it to us at NHFA, St Leonards House, Mill Street, Eynsham, Oxford, OX29 4JX

Name

Address

..... Telephone

Property and Possessions	Self	Spouse
Family home	£	£
Other property/land	£	£
Home contents	£	£
Cars, boats	£	£
Jewellery, antiques, collectables	£	£
Other	£	£

Financial Assets	Self	Spouse
Bank accounts	£	£
Building Society accounts	£	£
National Savings	£	£
Tessa's/PEPs/ISAs	£	£
Unit & Investment Trusts	£	£
Investment Bonds	£	£
Shares	£	£
Gilts	£	£
BES, VCT, EIS schemes	£	£
Business / Partnership interests	£	£
Expected Inheritances	£	£
Gifts made within last 7 years	£	£
Other	£	£
Totals (A)	£	£

Liabilities	Self	Spouse
Mortgages	£	£
Loans	£	£
Credit cards	£	£
Debts	£	£
Funeral expenses	£	£
Totals (B)	£	£

Net Estates	Self	Spouse
Total Assets (A)	£	£
Less total liabilities (B)	£	£
Less business/agricultural relief	£	£
Less nil-rate band	-£275,000	£275,000
Taxable Estates	£	£

**Potential inheritance tax
(taxable Estates at 40%)**

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IHT Client Case Studies

John & Ruth

John and Ruth, both in good health and aged 69 wanted to protect and preserve their Estate for the eventual inheritance of their two children.

Their assets totalling £800,000 comprised of a house worth £500,000 and savings of £300,000.

Their income in retirement was around £30,000 and their outgoings were £20,000 per annum.

As things stood they had a current potential Inheritance Tax Liability of £800,000 minus exempt band £275,000, equalling £525,000 @ 40% = £210,000 on second death.

An action plan was agreed and implemented by their NHFA Adviser and included:

- Varying ownership of property.
- Altering mirror wills to benefit their children.
- Investing £150,000 of their savings into a specialist Income producing Trust.
- Making use of immediate their annual gift exemptions to reduce the value of their Estate

- Purchasing of joint life second death life insurance cover of £120,000 written in trust, the premium costing around £100 per month

Implementing all the above meant that the inheritance for John and Ruth's children is protected without affecting their ability to fully enjoy their retirement.

Audrey

Audrey was in good health and aged 76. Whilst living within her means she could benefit from a little extra income to help finance her desire to travel and take holidays.

She was also concerned about the costs involved if she were to ever need long term care and the impact this and possible Inheritance Tax Liabilities might have on the value of her Estate she wanted to leave her children.

She also had two grandchildren who she wanted to help through their education now.

Audrey's assets comprised of her house worth £340,000 and savings of £20,000.

An action plan was agreed and implemented by their NHFA Adviser and included:

- Releasing capital from her house with a Lifetime Mortgage of £95,000
- From this money making gifts to fund her grandchildren's education of £30,000.
- Investing £50,000 in a specialist trust providing an additional income of £2,500 per annum
- Purchasing a pre-funded long term care insurance plan for a premium of £15,000.

The desired outcome was achieved. Meeting all of Audrey's personal objectives and aspirations over the coming years whilst helping to eliminate her potential Inheritance Tax Liability

Elizabeth

Elizabeth was in fair health for her age 79 and had assets totalling £700,000 which currently would result in an Inheritance Liability of £170,000.

She wanted to ensure that, where possible, the full value of her Estate passed to her only son. Her Income was quite adequate as it exceeded her outgoings.

An action plan was agreed and implemented by their NHFA Adviser and included:

- Fully utilising her current and previous year's annual gift exemptions.
- Placing £200k of cash assets into a specialist trust fund.
- Purchasing £100k of whole of life assurance in trust costing initially £4,284 per annum.

The above virtually preserved the Estate from day one of implementation with further savings accruing over the next seven years.

NHFA advice is available to all regardless of means

Infosheet 1 Choice and Interim Finance
Infosheet 2 Treatment of Property
Infosheet 3 The Legal Framework
Infosheet 4 L A Charging Procedures
Infosheet 5 Deprivation of Assets
Infosheet 6 Case Studies / Top Ten Tips
Infosheet 7 Treatment of couples
Infosheet 8 NHS Nursing Care Contribution
Infosheet 9 Inheritance Tax
Infosheet 10 Enduring Power of Attorney

NHFA care advice line 0800 99 88 33
www.nhfa.co.uk

Further information and advice on paying for care or free copies of the NHFA Long Term Care Guide can be obtained from:

St Leonard's House, Mill Street
Eynsham, Oxford, OX29 4JX

Care Advice Line: 0800 99 88 33
Telephone: 01865 733000
Facsimile: 01865 733001
Website: www.nhfa.co.uk
E-mail: enquiries@nhfa.co.uk