Financial planning for the life you want.

A GUIDE TO

Inheritance tax

Helping to ensure that your wealth can be passed down through the generations

FINANCIAL GUIDE

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A Guide to Inheritance Tax

Helping to ensure that your wealth can be passed down through the generations.

Estate preservation doesn't only affect the very wealthy. Rising property prices have meant it's now an issue for an increasing number of people. In order to protect family and loved ones, it is essential to have provisions in place after you're gone.

Unnecessary tax payments

The easiest way to prevent unnecessary tax payments such as Inheritance Tax (IHT) is to organise your tax affairs by obtaining professional advice and having a valid will in place to ensure that your legacy does not involve just leaving a large IHT bill for your loved ones. IHT is often called a voluntary tax because, with careful planning, the amount your estate has to pay could be reduced or removed completely. From writing a will, to understanding the exemptions and making lifetime gifts, there are several options to help mitigate IHT.

Could you save your beneficiaries thousands of pounds?

Effective IHT planning could save your beneficiaries thousands of pounds, maybe even hundreds of thousands depending on the size of your estate. At its simplest, IHT is the tax payable on your estate when you die if the value of your estate exceeds a certain amount. It's also sometimes payable on assets you may have given away during your lifetime, including property, possessions, money and investments.

IHT is currently paid on amounts above the £325,000 (£650,000 for married couples and registered civil partnerships) threshold for the current 2012/13 tax year, at a rate of 40 per cent. If the value of your estate, including your home and certain gifts made in the previous seven years, exceeds the threshold, IHT will be due on the balance at 40 per cent.

A substantial tax liability

Without proper planning, many people could end up leaving a substantial IHT liability on their death, considerably reducing the value of the estate passing to their chosen beneficiaries.

Your estate includes everything owned in your name, the share of anything owned jointly, gifts from which you keep back some benefit (such as a home given to a son or daughter but in which you still live) and assets held in some trusts from which you receive an income.

Useful for tax planning

Against this total value is set everything that you owed, such as any outstanding mortgages or loans, unpaid bills and costs incurred during your lifetime for which bills have not been received, as well as funeral expenses.

Any amount of money given away outright to an individual is not counted for tax if the person making the gift survives for seven years. These gifts are called 'potentially exempt transfers' and are useful for tax planning.

A matter of trust

Money put into a 'bare' trust (a trust where the beneficiary is entitled to the trust fund at age 18) counts as a potentially exempt transfer, so it is possible to put money into a trust to prevent grandchildren, for example, from having access to it until they are 18.

However, gifts to most other types of trust will be treated as chargeable lifetime transfers. Chargeable lifetime transfers up to the threshold are not subject to tax but amounts over this are taxed at 20 per cent, with a further 20 per cent payable if the person making the gift dies within seven years.

Maintaining your standard of living

Some cash gifts are exempt from tax regardless of the seven-year rule. Regular gifts from after-tax income, such as a monthly payment to a family member, are also exempt as long as you still have sufficient income to maintain your standard of living.

Any gifts between husbands and wives, or registered civil partners, are exempt from IHT whether they were made while both partners were still alive or left to the survivor on the death of the first. Tax will be due eventually when the surviving spouse or civil partner dies if the value of their estate is more than the combined tax threshold, currently £650,000.

How much tax should be paid?

In most cases, IHT must be paid within six months from the end of the month in which the death occurs. If not, interest is charged on the unpaid amount. Tax on some assets, including land and buildings, can be deferred and paid in instalments over ten years. However, if the asset is sold before all the instalments have been paid, the outstanding amount must be paid. The IHT threshold in force at the time of death is used to calculate how much tax should be paid.

IHT can be a complicated area and without proper tax planning, many people could end up leaving an IHT liability on their death, considerably reducing the value of the estate passing to chosen beneficiaries. To ensure that your family benefits rather than the taxman, it pays to plan ahead. ■

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Planning for IHT

There are a number of things you could do to reduce your family's potential IHT bill:

Make a will – an effective will could help to reduce your IHT bill.
Look into exemptions – there are a number of exemptions you could use to reduce the value of your estate. For example, moving assets between spouses or registered civil partners does not create an IHT liability.
Consider gifts – if you can afford to give away some of the assets that you own, it may be possible to reduce the size of your estate.
Think about life assurance – a life assurance plan won't actually lessen the IHT bill, but the proceeds could be used to help pay the bill on death if written in an appropriate trust.
Consider trusts – if structured carefully, trusts can help to reduce or even eliminate your IHT liability.

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