bhp law

A Guide to Inheritance Tax Planning

one in a series of comprehensive guides to assist you in managing your affairs

Wills, Trusts & Probate

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Due to the dramatic increase in property values over the last few years, many people find that they have assets (perhaps unknowingly) valued at over the current Inheritance Tax nil-rate band of £325,000.

Inheritance Tax is presently charged at the rate of 40% on the value of the assets exceeding the nil-rate band (with some exceptions as to business and agricultural property).

Thus, an estate consisting of a home worth £325,000 and a further £100,000 of other assets will pay tax of £40,000.

Assets passing to a spouse are exempt for Inheritance Tax purposes, and since 2007 it has also been possible to transfer nil rate bands between spouses such that if the first spouse to die leaves all their estate to the survivor then on the death of the second spouse they will be able to leave £650,000 free of inheritance tax.

Although to a certain extent, we are ultimately in the hands of the Government as to how effective any Inheritance Tax planning may be in the future, it is currently possible to mitigate your liability in one or more of the following ways:

Lifetime Trusts

A lifetime trust is a vehicle by which you can transfer assets (such as property or cash) into a trust which is managed and invested by trustees (of which you could be one), for the benefit of one or more beneficiaries.

There are various types of trust which can be created depending upon your personal circumstances.

Transferring assets into a lifetime trust for Inheritance Tax planning can be very tax efficient, provided you survive for 7 years after the transfer.

There are, however, potential Capital Gains Tax and Income Tax implications which apply to lifetime trusts and you should make sure you talk these through with a legal advisor before deciding what to do.

Will Trusts

Will trusts are particularly appropriate where a husband and wife are keen not only to mitigate their potential joint Inheritance Tax liability but also to protect assets against vulnerability in old age.

It is possible for a couple to split their assets (including their home) into separate names. Their Wills could then direct those assets held in sole names (which could include a half share in the house) into a simple form of trust on the first death.

The assets are held on trust for the surviving spouse. However, because the assets are held in a trust rather than belonging outright to the surviving spouse, they cannot be used by the Local Authority to pay care home fees. In addition, it is possible, if appropriate, to pass assets to children from the trust. If the surviving spouse lives for a further seven years, these gifts may be free of Inheritance Tax.

Lifetime Gifts

Many people ask if they can "give away" assets such as their home or cash in order to reduce their potential Inheritance Tax liability or to protect their vulnerability in old age.

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Whilst you are of course free to gift whatever belongs to you during your lifetime, there are pitfalls that must be addressed before you choose to make the gift.

For example, the "reservation of benefit" rule says that if you continue to benefit from the asset you have transferred by way of a gift, the asset is still counted as part of your estate for Inheritance Tax purposes. You must also survive seven years if the full Inheritance Tax saving is to be effective.

The above are some of the most commonly used ways in which to mitigate your Inheritance Tax liability, however, each person has their own personal and financial circumstances which must be considered fully before a decision is made.

For further information about Inheritance Tax planning please contact a member of our Wills Trusts and Probate team.