Inheritance Tax planning fact sheet

There are a number of exemptions that you may wish to take advantage of for Inheritance Tax lifetime planning.

Inheritance tax payable on your death

Married couples are entitled to two nil rate bands (currently £325,000 each) following both deaths and that anything over and above this would be taxed at 40%.

Annual exemption

An individual can give away up to £3,000 annually each tax year (6 April to 5 April) without any Inheritance Tax consequences. This amount can be carried forward if unused, but for one tax year only.

Normal expenditure out of income gifts

To claim this exemption, you can give away any excess income which you do not spend in any year to any taxable beneficiary, provided that such gifts are intended to be part of a pattern, are genuinely out of surplus income after expenditure and do not affect your normal standard of living.

Tax efficient investments

There are various tax-efficient investments which can be utilised to minimise your exposure to Inheritance Tax. Whilst we are unable to provide you with financial advice, you may wish to discuss this particular area in greater details with your financial adviser who could advise you in relation to such products, for example, gift and loan schemes, discounted gift trusts or investments in certain schemes or AIM listed companies. We can refer you to a financial adviser if you do not have one.

Small gifts

Gifts to different persons from those benefiting from Lifetime gifts above in any year not exceeding £250 are exempt.

Gifts in consideration of marriage

This is somewhat specific. However, you can make gifts of £1,000 to anyone you know who is getting married. There is a larger amount of relief available for close family members.

Transferring your pensions/life policies into Trust

Whilst not strictly an exemption there is an advantage of reducing your estate for Inheritance tax purposes by writing certain policies into Trust.

Lifetime gifts

Transfers of value in each fiscal year not exceeding £3,000 can be made by each of you free of Inheritance tax. Any unused amount can be carried forward for one year only adding to the allowance for that year only.

Any gifts in excess of the annual exemption effectively form part of your taxable estate for seven years, although the tax upon the gifts themselves decreases on a sliding scale after the period of three years has elapsed, depending upon how much you give away.
Outright gifts of assets and survival for seven years

You might also wish to consider removing some assets from your estates by gifting them during your lifetime. Any gifts made by an individual of more than £3,000 in any one year to an individual outright are ‘potentially exempt transfers’ for Inheritance Tax purposes. If you were to survive the date of the gift for a period of 7 years, then the gift would be deemed to be outside your estate for Inheritance Tax purposes, provided that you do not reserve a benefit in the subject-matter of the gift. If, however, you were to die within the 7 year period, the value of the gift would be ‘clawed back’ into your estate for Inheritance Tax purposes.

There is a taper relief available for Inheritance Tax but this only operates to taper away the amount of the tax payable on the gift, not the amount of the gift itself, and will therefore only apply if you give away more than £325,000. This may apply provided that the donor survives the date of the gift by at least 3 years and the value of the gift exceeds £325,000, or the current nil-rate band amount. The calculation will also take into account any other gifts made during the preceding 7 years.

Any gifts into trust are chargeable transfers and if the value gifted into trust within a 7 year cycle exceeds £325,000 then there is an immediate Inheritance Tax charge of 20% on the excess with a further 20% payable if you were to die within 7 years. Again there is a taper relief applicable in respect of the tax on such gifts but the taper cannot taper away the amount of the tax below the initial 20% figure payable upfront.

Discretionary Trusts

A further option available to you is to set up a Discretionary Trust during your lifetime. You could, for example, include your children or your remoter issue as potential beneficiaries under the trust. If you were to transfer assets into a Discretionary Trust, you would lose control of the assets and they would no longer be available to you, nor would the income from them. The money would be controlled by trustees, appointed by you, who would exercise their discretion as to how and when gifts were to be made from the trust to the beneficiaries.

The benefit of setting up a Discretionary Trust is that if you survive for 7 years from the date of the setting up of the trust, you will have reduced your estate by the amount of money paid into the trust, provided that there is no reservation of benefit for Inheritance Tax, as mentioned above. You should not set up such trusts or add into them more than £325,000 on current figures, unless you wish to trigger a lifetime Inheritance Tax charge, as mentioned above.

Gift of property

The same provisions as above will apply in that it will be treated as a potentially exempt transfer for Inheritance tax and therefore if you died within seven years, this would remain part of your estate for inheritance tax. The complication with your property is that you are likely to continue to benefit from it and so for this to fall out of your estate completely for Inheritance tax you would need to pay the market rent for the occupation of the property. This, of course, means that the recipients of the rent will be taxed on this for income tax purposes as this will be treated as rental income.

This situation may also give rise to payment of Pre-owned assets tax, which is income tax.
For more information, please seek the advice of one of our specialist legal team.

Edward Hands & Lewis
The Old School Rooms
346 Loughborough Road
Leicester
LE4 5PJ
0116 266 5394
www.ehlsolicitors.co.uk
info@ehlsolicitors.co.uk

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