

Estate Planning

Ever since the Labour government came to power in 1997, there has been speculation that the inheritance tax (IHT) regime would be tightened up. So far this has not happened and it now looks as though the government has a more relaxed view about passing family wealth down to the next generation.

Certainly the current regime is generous.

- The majority of lifetime gifts of capital are treated as 'potentially exempt transfers' or PETs. So long as the donor lives for at least seven years from making the gift there will be no possibility of an IHT charge whatever the size of the gift.
- Assets falling into the categories of either agricultural or business property may never give rise to an IHT liability due to the availability of relief at 100%.

However, for many of us IHT is now a potential problem.

- Many are simply not in a position to make substantial lifetime gifts of capital. As a consequence there is likely to be significant capital value in our estates on death. The position then is that the first £255,000 of value is tax-free (being covered by the 'nil rate band') but any balance, subject to any exemptions and reliefs, is charged to IHT at 40%.
- Typically the most valuable assets in an estate are the family home and investments. These are unlikely to be eligible for any IHT reliefs.

It is important therefore to consider ways of mitigating any potential IHT liability. We give guidance in this bulletin on some of the main opportunities for minimising the impact of the tax.

Any plan must take account of your circumstances and aspirations. The need to ensure your financial security and that of your family cannot be ignored. If you propose to make gifts, the interaction of IHT with other taxes needs to be carefully considered. We hope that this bulletin deals with some of the issues relevant to you. We would welcome the opportunity to discuss estate planning with you in more detail.

Exemptions

Certain gifts made by individuals qualify for specific IHT exemptions. We provide a list of the main ones below. Consider using one or more of them to build up funds gradually outside your estate without incurring an IHT liability. The use of trusts in conjunction with exemptions may enable retention of control over the funds. A husband and wife can each take advantage of the exemptions.

The **annual exemption** amounts to £3,000 per tax year. It may be carried forward one year if unused but not thereafter.

Small gifts to individuals not exceeding £250 in total per tax year per recipient are exempt.

Gifts made out of income that are typical and habitual and do not result in a fall in the standard of living of the donor are covered by the **normal expenditure out of income** exemption.

Gifts for **family maintenance** are exempt. This would include gifts for the education of children (but not grandchildren).

Gifts made in **consideration of marriage** are exempt up to £5,000 if made by a parent, with lower limits for other donors.

Charitable gifts are exempt whether made during lifetime or on death.

One of the most important exemptions is that for **gifts between spouses**. This applies to both lifetime and death transfers and to transfers into trust as well as outright transfers. It may be desirable to use the spouse exemption to ensure that both spouses can make full

use of exemptions and the £255,000 nil rate band. The spouse exemption does not apply where couples live together as partners rather than marry.

Although not strictly an exemption the **nil rate band** of £255,000 can be used to make 'tax-free' gifts. Given the seven year cumulative nature of IHT it is possible for individuals to make gifts equal to the nil rate band once every seven years. For wealthy individuals in a position to make substantial lifetime gifts of capital this can be very significant. For example, an individual in their early fifties who lives to age 80 could make gifts totalling £1million within the protection of the nil rate band over the remainder of their life.

Wills

As the main IHT liability is likely to arise on death, an efficient and up to date Will is important. There are other strong, non-tax reasons for making a Will. A Will should enable your estate to be unlocked quickly and handled by someone you trust. Furthermore, if you die without a Will, the intestacy provisions will apply and may result in your estate being distributed in a way you would not have chosen.

Checklist

- Do you have a Will?
- Where is it kept - do you and your family know?
- Is it up to date?
- Does your Will make full use of IHT exemptions and reliefs?
- Do you have adequate life assurance?

The chosen distribution of an estate will vary enormously and depend upon the individual's particular circumstances. However, some general points can be made.

Continued overleaf

If you are **married** then you are likely to want to leave much of your wealth to your spouse free of IHT. However, assuming that you have children, you should consider leaving £255,000 to them so that your nil rate band is used and an IHT saving of £102,000 (being £255,000 x 40%) is secured. Where it is not desirable or practical to leave £255,000 directly to your children you may consider a trust instead. Indeed there is a way of leaving all of your wealth to your spouse which still enables use of the nil rate band. Such an arrangement is referred to as a debt-charge arrangement or a Loan Plan Will. In essence the plan works by leaving everything to the surviving spouse but in addition leaving £255,000, typically in the form of a charge on the house, to a discretionary trust. On the death of the first spouse there is no IHT liability. On the death of the surviving spouse, his or her estate is reduced by the £255,000 owed to the trust.

If you are **single** then the position is rather different. You have your nil rate band available and possibly some other IHT exemptions and reliefs but if your estate is worth more than £255,000 there is likely to be an IHT liability on death whoever you choose to leave it to. Therefore consider the feasibility of giving away wealth during your lifetime which, so long as you survive for at least seven years from the gift, will be IHT-free. You may want to consider a term assurance policy to protect against death

within the seven-year period. If you are single but part of a 'permanent' couple then a Will is essential because the intestacy provisions provide nothing at all for an unmarried partner.

Even where a Will does not distribute the estate in the most tax efficient way, all may not be lost. In the two-year period following a death, the terms of a Will can be varied using a Deed of Variation. However, the use of this should be viewed as a backstop. Trying to agree on a revised distribution of an estate can often lead to serious family arguments!

Reliefs

Business or agricultural property may be eligible for IHT relief. The relief takes the form of a discount in the value becoming chargeable to IHT either on a lifetime transfer or on death. Availability of the relief is dependant on the property satisfying the definition of business or agricultural property and on having been owned for the necessary minimum period. The nature of the property will determine the rate of relief which will be either 100% or 50%. The rules are detailed and complex but we provide in the box right a brief summary of the requirements for the relief. In cases where 100% relief is available there is little

Business and agricultural property

100% relief

Unincorporated businesses owned for at least two years

Unquoted shares in a trading company owned for at least two years

Agricultural land owned and farmed for at least two years

Certain tenanted agricultural land owned for at least seven years

50% relief

Certain land and buildings owned personally for at least two years and used in the owner's partnership or company

Controlling holdings in quoted trading companies owned for at least two years

Tenanted agricultural land owned for at least seven years but not qualifying for 100% relief

incentive, from an IHT point of view, to make lifetime transfers of such assets. Additionally, no capital gains tax will be payable where the asset is included in the estate on death.

What will happen to any business or agricultural property included in your estate on death? Leaving it to your spouse will waste the relief. Consider where possible leaving such property to someone else - perhaps even a discretionary trust of which your spouse is one of the beneficiaries.

Summary

Estate planning is a complex area and there is no substitute for a detailed review of your own individual position. Whatever your circumstances IHT is a potential problem for anyone worth in excess of £255,000. However some early planning to use available exemptions and reliefs and an up to date Will can help enormously. Please talk to us soon if you have any queries arising from this bulletin or wish to discuss estate planning in more detail.

Case study

Roger is a healthy 64 year old who has never made any lifetime gifts of capital. He has two adult children and four grandchildren. His wife has recently died leaving her estate of £800,000 all to Roger. She had never made any lifetime gifts. Roger's other assets are:

- Majority shareholding in the family trading company worth £2million (eligible for business property relief at 100%)
- Investments, cash etc £400,000
- Family home £700,000

If Roger were to die and assuming he leaves his entire estate to his children his IHT liability would be £658,000.

Some IHT planning could reduce this significantly. Many factors need to be considered including his need for income and capital during the remainder of his life and the impact of other taxes particularly capital gains tax. However, the following

could be considered.

- A Deed of Variation to redirect £255,000 of his wife's estate to the children or possibly a discretionary trust of which Roger can be a beneficiary. This will enable her nil rate band to be used.
- Setting up a nil rate band trust for the children or grandchildren. It may be possible for Roger to repeat the exercise again in seven year's time. On this basis he would remove a total of £510,000 from his estate.

Roger may wish to consider some lifetime planning with the family home. This is a rather more difficult area and assuming Roger wishes to carry on living in the property can involve some complex planning. It is not something to be undertaken by the faint-hearted!

However, the potential IHT saving just from the Deed of Variation and setting up a nil rate band trust would amount to £204,000.

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