Women's Institute

Inheritance Tax

The NFWI created this booklet and the Financial Services Authority
paid for this work as part of the National Strategy for Financial Capability.

FSA®

This booklet forms part of a series of five, written by the speakers at You and Your Money - A Conference on Personal Finance, held at Denman College in May 2008. The conference offered the opportunity to discover where to find advice, and how to keep track of finances, choose financial products, plan ahead, and stay informed about financial matters.

This booklet was written by Martin Morris-Coole.

This booklet was created by Denman College, and the Financial Services Authority paid for this work as part of the National Strategy for Financial Capability. We aim to give you general information to help you make financial decisions. The information does not constitute financial or other professional advice; for advice about your own circumstances, you should consult a professional adviser.
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Research from Her Majesty's Revenue & Customs suggests the number of estates (see below) caught by inheritance tax (IHT) has more than doubled over the last ten years.

However, in 2006, only 8% of estates were liable to pay IHT, although the recent rises in property values suggest that this percentage is likely to increase significantly within a relatively short time.

In 2006/2007, 37,000 estates paid IHT – around 80% of these could have avoided all, or part of, it with some forward planning.

What is inheritance tax?

In the UK, inheritance tax is a tax paid on your 'estate' when you die , if you are regarded as UK domiciled. The basic concept of domicile is that a person is domiciled in the country that he or she regards as their real home. Domicile is normally acquired through birth, through parents or through long-term residence.

Your estate includes your home, car, investments, bank accounts, and any other assets you have given away in the seven years before you die. Some things will be taken off before the value of your estate is worked out – for example, any bills you haven't paid, your funeral expenses and exempt gifts (see below).

You also have to pay IHT on some gifts you make while you are alive, for example if you pay money into a particular type of trust.

How much has to be paid?

You can leave an estate worth up to £312,000 (2008/9) [1] before any IHT is payable – this is called the 'nil rate band' (NRB). Above the NRB, tax of 40% is payable, and 20s% on some types of gift made during your lifetime.

Every individual has a NRB, which until recently could be lost on death if transfers were made between spouses or civil partners. Following the Chancellor's pre-Budget statement on 9th October 2007, any part (calculated as a percentage) of the NRB which is not used on the death of the first spouse or civil partner can now be carried forward and used by the surviving spouse or civil partner on their death. For example, previously, if a husband died and left everything to his wife, his NRB wasn't used because there is no IHT on transfers between spouses or civil partners.

Since October 2007 any unused proportion of his NRB could be claimed when his wife dies. This could have the effect of doubling the previously available NRB.

There are some situations where IHT won't be payable on your estate at all – see 'exempt transfers' overleaf.

[1] The NRB will be £325,000 (2009/10) and £350,000 (2010/11).

Who pays inheritance tax?

If you are regarded as UK domiciled at the time you die your estate is normally liable for inheritance tax on your assets no matter where they are in the world.

You may find you are subject to UK IHT even though you are not actually living in the UK.

Leaving your estate by making a transfer or a gift

You make a 'transfer' when you either leave assets (including money and property) to beneficiaries, who can be individuals, groups or organizations, when you die, or if you make certain gifts while you are alive.

Exemptions

IHT isn't payable on everything you leave, or gifts you make:

- You can leave money to your spouse or civil partner, even if you are separated, as long as you're both living in the UK. If you live in the UK but your partner doesn't, you can leave them up to £55,000 without being liable for tax.
- You can give away up to £3,000 a year without paying IHT. You can carry over any unused allowance to the next year only.
- You can also give small gifts to people – up to £250 per person in each tax year.
- Gifts that come out of your normal expenditure (are exempt as long as: – you make them regularly from your income (NOT from your savings or investments) ; and you don't reduce your standard of living by making them.
- You can make gifts to friends or relatives when they get married or enter into a civil partnership. Parents can give their children up to £5,000 each, and grandparents can give each grandchild up to £2,500. You can give your husband, wife or civil partner a maximum of £2,500; and anyone else can give up to £1,000.

- If you give to a UK charity or political party, your gift is exempt from IHT.
- You can leave things to some national institutions without having to pay IHT. For example, you can donate a work of art to a public gallery.
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Potentially Exempt Transfers (PET)

These are gifts that will be added to the value of your estate if you die within seven years of making them.

If you die within seven years, the value of the gift will be taken from your NRB when the amount of inheritance tax is worked out.

If the total amount comes to more than the NRB, you'll have to pay what's left out of your estate.

The amount of tax you pay on your PET depends how soon you die after making the gift – this is called 'taper relief'. For example, if you die within three years of making a PET, you'll still have to pay all the IHT you're liable for. But if you die, say, six years after making the PET, you only have to pay 40%. This drops to 20% on the seventh year, and nothing the year after that.

Gifts with reservation

If you give someone something on the condition that you can still enjoy or benefit from it, you may still have to pay IHT when you die. For example, if you give your son a painting but keep it on a wall in your home until you die, its value will still be included in your estate.

How to reduce the effects of IHT

There are some ways in which the effects of IHT on an estate can be reduced or even removed altogether. However, these cannot be looked on as being applicable in every case and very careful planning is necessary to ensure that whatever is done is both practical and effective according to personal circumstances.

You can reduce the impact of IHT through:

- insurance
- trusts
- wills

Insurance

Whole of life assurance

This form of policy is worked out to pay the IHT "guessed" as being due on an estate and is usually written in trust to the beneficiaries. For example, you could put up to £3000 a year into a policy, to cover inheritance tax, without incurring an additional liability on the premium. But to do this, you need to be in good health and be sure you can afford all the payments.

The beneficiaries can use the proceeds to pay some or all of the inheritance tax due. If you're thinking about doing this, you should get professional advice because many policies in the past have proved to be expensive and/or worthless.

Term assurance

If you're making a PET, you could take out a seven-year decreasing term assurance policy (a "gift inter vivos" plan) at the same time. The amount you are insured for will cover the IHT liability if you die within the seven-year period. The insured sum goes down in line with the taper relief, and has no value after seven years.

Trusts

You can use a trust to preserve wealth for future generations. By putting your assets in a trust, you can give your family and others financial security, as well as give yourself peace of mind.

A trust lets you decide how assets should be distributed in the future. This can be useful if you're making a trust for a child, or for someone who can't manage the money or property for themselves. It can let you decide when the benefits will be paid, and who they will go to.

There are several forms of trust and they can be "flexible" or "absolute". The type you make will depend on your circumstances. If you are thinking about making a trust, you should first get advice from a suitably qualified independent financial adviser or solicitor (see useful contacts).

Types of trust

Flexible trusts

A flexible, or discretionary, trust is subject to the 'relevant property' regime. When you pay money into the trust, you will be charged 20% if your payment is over the NRB. You will also have to pay 6% every ten years if the value of the trust is more than the NRB at the time. And there will be an exit charge to pay when capital leaves the trust.

Absolute trusts

An absolute, or bare, trust is one where beneficiaries have the legal right – to the trust capital and income. The beneficiaries can take possession of the trust property when they turn 18 (England and Wales).

If you create an absolute trust, you are making a PET so the trust won't be subject to the 'relevant property' regime, as applies to Flexible Trusts. The trust's beneficiaries will be charged tax on the income if they are over 18, and the assets will be part of the beneficiaries' estate(s) for IHT.

Which trust?

The type of trust you choose will depend on your financial and family circumstances.

A flexible trust is useful if you want to have more control over who will benefit and when, and if you want to include yourself as a beneficiary. The major drawback is that the flexible trust is subject to the relevant property regime, with the necessity to pay the taxes as above. But you could think about a flexible trust if the amount you're putting in the trust doesn't take you over your NRB, or your gift is exempt from inheritance tax.

An absolute (or bare) trust will be useful if you want to make large gifts on which your estate would otherwise have to pay inheritance tax.. But you need to be confident that you won't need to change the beneficiaries – you won't be able to do this once you have set up the trust.

Wills

Everyone should have a will. You should review yours regularly, especially if your personal circumstances change, for example if you get married, divorced or have children. If you die and you haven't made a will, you die "intestate". This means everything you own would be distributed under the "rules of intestacy", and your estate may not end up being apportioned as you wanted it to be.

You should make a will not only to make sure your estate goes to the right people, but also to:

- distribute your assets and belongings in the way you want;
- explain what would happen to your children if you died – for example, who would look after them and provide for them;
- say what you want for your funeral;
- appoint the people (called executors) to sort out your estate;
- help reduce inheritance tax;
- provide for your pets;
- leave money to a charity;
- explain what you want to do with what you leave behind:
- – will you leave everything to your partner; or
- – will you control your estate with a trust?

You can write your own will, but it may also help you to speak to a solicitor (see opposite).

Useful Contacts

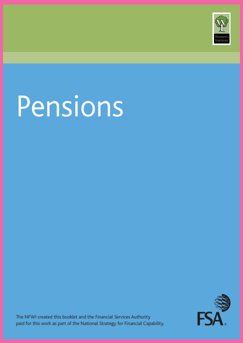
For more information on legal matters, speak to a solicitor.

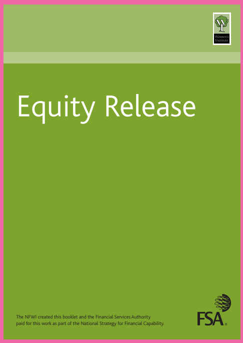
You can find one by contacting:
The Law Society for England & Wales
0870 606 2555
www.lawsociety.org.uk.

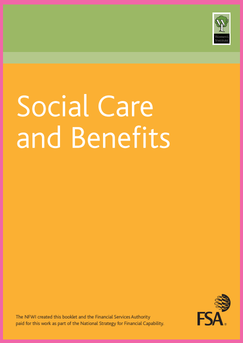
To find an independent financial adviser in your area:
www.unbiased.co.uk
0800 085 3250

For general information about tax and other matters, see:
www.direct.gov.uk

Other guides in the series







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