A Whitechurch

Understanding Investment

Publication

A Guide to Inheritance Tax

September 2007

Whitechurch Securities Limited
Kings Weston House
Kings Weston Lane
Bristol
BS11 0UR

Tel: 0117 373 0400
E-mail: info@whitechurch.co.uk
Website: www.whitechurch.co.uk

WHAT IS INHERITANCE TAX?

Inheritance tax (IHT) is a tax levied on your estate when you die. It is potentially charged at a rate of 40% on the value of everything you own above the nil rate band (NRB) threshold.

Your estate is basically everything you own, including your main property, second property, cars, boats, life assurance policies, life assurance bonds and other investments including your cash holdings as well as personal effects such as jewellery.

Currently the NRB is £300,000 (2007/08) and will increase in stages to £350,000 in 2010/11. When you die you are not liable to tax on any assets up to this amount. However, anything over this amount could be taxed at a rate of 40%.

Growing problem

Inheritance tax affects more and more people each year. One reason for this is the rapid rise in house prices over recent years, which has taken many estates over the NRB. In tax 1996/97 HMRC received £1,558 million in IHT and over the past 10 years up to 2005/07 this has increased to £3,300 million. (Source: HMRC statistics, July 2007)

Future planning

So without any IHT planning your family could be faced with a large tax bill when you die and this has to be settled before they can place their hands on your estate. So they will have to raise money if they have insufficient accessible cash funds to pay this bill.

With some forward planning you can ensure that the people you want to benefit from your estate actually do benefit. One of your first considerations should be to make a **Will** to ensure your estate goes to the people you want it to (see later section on Wills).

The first key help available is the **'spouse exemption'**, which allows all assets to be passed from one spouse/civil partner to the other on the death of the first person, with no IHT to pay. However, this can sometimes mean that you just delay the problem as the increased estate of the surviving spouse/civil partner will be payable on their death.

If nothing is done, then HMRC can easily become a large beneficiary of your estate as shown in the example below:

Example

Stephen and Carol are married with 3 children. They jointly own a house valued at £340,000 plus investments of £250,000 making an estate value of £690,000. They have not taken steps to reduce their IHT liability. If Stephen dies first, leaving everything to Carol, there will be no IHT liability on Stephen's death. However, on Carol's subsequent death, IHT will be payable and HMRC will benefit from the state with the 3 children losing out.

Estate minus nil rate band at death (£690,000 - £300,000) £390,000
Taxable estate x IHT death rate = IHT payable (£390,000 x 40%)
£156,000
The three children would share the balance of the estate (£690,000 - £156,000)
£534,000

Leaving each child with £178,000 (£534,000 divided by 3)

Therefore, your children are losing out on a total of £156,000 of your hard earned wealth.

WILL IHT APPLY TO ME?

First you need to work out your estate to see if it is over £300,000, which is the Nil Rate Band (NRB) for the 2007/08 tax year. If your estate is worth over £300,000 then you should consider tax solutions available to you and we strongly recommend that you speak to our IHT Specialist.

IHT calculator

Assets	Estimated value
Value of main home	
Second home, business property, land etc.	
Car(s), caravan(s), boat(s) etc.	
Household contents and personal effects	
Bank and Building Society Accounts	
Investments (shares, bonds, offshore accounts, ISAs, PEPs)	
Life insurance policies (if not under trust)	
Pensions lump sum (if not under trust)	
Other assets including previous gifts	
Sub Total	
Less any liabilities	
Mortgage(s)	
Loan(s), hire purchase(s), credit card(s)	
Sub Total	
Calculating your IHT liability	
Subtract nil rate band	
Subtract any exemptions	
Balance	
Potential IHT Liability (Balance x 40%)	

What could my IHT liability be?

This table indicates what level of tax your family or executors would have to pay, assuming your whole nil rate band is available and you did nothing to reduce the IHT liability, based on 2007/08 tax year figures.

Estate Value	Amount Taxable	IHT payable at 40%
£300,000	£0	£0
£400,000	£100,000	£40,000
£500,000	£200,000	£80,000
£600,000	£300,000	£120,000
£700,000	£400,000	£160,000
£800,000	£500,000	£200,000
£900,000	£600,000	£240,000
£1,000,000	£700,000	£280,000
£1,500,000	£1,200,000	£480,000

HOW CAN I REDUCE MY IHT BILL?

The main approach to IHT mitigation is to reduce the value of your estate over a number of years. The smaller your estate when you die, the less your IHT bill is likely to be. The last approach is to set up life cover on yourself to provide the executors/beneficiaries cash funds to pay the IHT bill.

There are many approaches to reduce your IHT liability such as those outlined below. Some are more complex than others and may not be suitable for you, so it is always important to get professional advice.

- Own assets which are not liable to IHT
- Give cash gifts to family members and use exemptions
- Write a will to utilise NRB
- Utilise potentially exempt transfers
- Ensure assets are individually owned at least up to NRB values
- Write your life assurance policy/ies into trust
- Put gifts in trust for beneficiaries
- Will gifts to charities, museums and political parties
- Considering an equity release plan or creating a debt on the estate

Write a Will

Writing a will and keeping it up to date is an essential part of IHT Planning.

Many people wrongly believe that their whole estate will go to their spouse /civil partner when they die. However, this only applies if a will has been drawn up and provides for this to happen.

Writing a Will means you can specify exactly how you would like your assets to be distributed after your death and allows you to name your executors as well as guardians for your children. It can also be used to reduce your tax bill.

Even if you have a will, it must be up to date and reflect your wishes, your assets and your current tax position. Marriage, civil partnership, divorce or dissolution can all have an impact on an existing will and in some cases make them void.

If a person dies without having made a Will, then they are said to have died ‘intestate’. In such cases a variety of problems can arise:

- Assets being distributed to individuals according to the intestacy rules rather than to those chosen by the deceased.
- Possible delays in the settling of a deceased’s affairs, which could prove distressing for a surviving spouse/civil partner or other members of the family.
- An avoidable IHT bill being incurred.

Within your Will you can include specific gifts to reduce the taxable size of your estate. It may not be tax efficient to leave everything to your spouse/civil partner as you are effectively just passing on the tax burden.

Gifts and Exemptions

You can reduce the value of your estate and therefore the amount of IHT you are liable for by 'gifting away' some of it before you die. Some gifts are completely free of IHT (i.e. do not form part of your estate when you die) whereas others will still be liable to tax. The following summarises the gifts you can make and exemptions available.

Spouse/Civil Partner Exemption

There is no IHT to pay on transfers between most married couples or civil partners living in the UK*, whatever the amount. Effectively the amount liable to IHT is deferred until the death of the second spouse/civil partner.

* For those married to a non UK domiciled spouse/civil partner living in the UK, exemption is limited to £55,000 after the NRB has been taken into account.

Annual Exemption

Individuals are entitled to give away £3,000 in total in any tax year, free from IHT. This allowance can be backdated by one year, so where the full £3,000 is not used in one tax year it can be carried forward to the next. This means a married couple could give away a total of £6,000 a year to their children without incurring IHT (or £12,000 if the previous year's allowances were unused).

Small Gift Exemption

Outright gifts of up to £250 in total, to each of any number of people in one year, are exempt from IHT. The total of any one person's allowance cannot form part of any larger gift.

Marriage or Civil Partnership Gifts Exemption

Gifts made in consideration of a marriage or civil partnership are exempt as follows:-

Donor	Amount
Parent	**Up to £5,000**
Grandparent	**Up to £2,500**
Others	**Up to £1,000**

Normal Expenditure from Income

Lifetime gifts are gifts made by an individual while they are alive. To benefit from this exemption the gifts need to be regular (e.g. yearly) and out of true income (e.g. after-tax earnings, income, dividends and interest from investments), but not from capital. Provided they do not affect the Settlor's usual standard of living, they should be exempt from IHT. There is no upper limit on the amount which can qualify for this exemption. However, the exemption itself can only be confirmed on death.

Other Exemptions

Lifetime gifts for the upbringing of children and other dependants are free form IHT liability. Also exempt are gifts and bequests:

- To charities
- To political parties
- To universities

- For national purposes
- For public benefit

TRUSTS

A trust is one way to move money out of your estate in order to reduce your IHT bill. It avoids potentially lengthy probate delays, so that the people you want to benefit from your estate do so as quickly as possible. However, you should be aware that with some trusts you have to forgo access to some of the original capital as well as any future growth.

Simply put, a trust allows you (the Settlor) to entrust your assets to a group of people (the trustees). The trustees are the legal owners of the assets and manage the assets for the benefit of your trust's beneficiaries. It is the trustees responsibility to manage and ultimately distribute the Trust Fund to the beneficiaries.

You can write all manner of assets in trust, including investments, life assurance policies and death benefits.

Certain trusts not only allow you to pass on your wealth when you die, but also give you access to regular 'income' while you are alive, in the form of withdrawals.

By not writing your assets in trust, any amount within your estate over the NRB would potentially be liable to IHT at 40%.

WHAT TO DO NEXT?

It is essential that you and your financial advisor assess the nature and scale of your IHT liability. To make a start on this you can use the checklist below and the IHT calculator mentioned earlier.

Answers 'No' or 'Don't know' are an excellent place to start in discussions with your financial advisor.

Also, successful IHT planning should be a continuous process rather than a one-off exercise. Therefore, it is important to regularly review any IHT arrangements you have made.

Checklist	Yes	No	Don't know
Have you made a will?			
If yes, is it up to date?			
Are you making full use of your various IHT exemptions?			
If married / in a civil partnership, are you making full use of both of your nil rate bands?			
Are all life assurance policies you hold written in trust?			
If you are in a pension scheme or have a personal pension, are death benefits included?			
If so, have you given up to date details of the person/people to whom you wish these benefits to be paid?			
If you have an old-style retirement annuity policy, is the death benefit in trust?			
Have you made, or are you making, full provision for retirement income?			

DU YOU NEED ADVICE?

We hope that you find this guide useful and that it has gone some way in answering your questions regarding IHT planning. Our guide is quite in-depth but does not examine all areas of IHT planning, which can be a very complex area.

Ultimately, after reading this guide, if you feel that you need to seek expert, independent financial advice regarding IHT planning or any decisions concerning these areas then we recommend that you contact us and ask to speak to one of our financial advisers.

To speak to one of our qualified financial advisers please call Nexus Financial Planning on 01278 439 494 or e-mail us at **office@nexusifa.co.uk**

IMPORTANT NOTES – PLEASE READ

This guide was prepared by Whitechurch Securities Ltd using sources believed to be reliable and accurate. The opinions are our judgement at the time of writing.

Do you need advice?
This publication contains product specific details only and unless we have complete up to date written details of your financial circumstances and requirements we cannot and will not offer any opinion as to the suitability of any investment for any client. Any response to this publication will therefore be on the basis that client specific advice has not been given. These investments are not suitable for everyone. If you have any doubt whether they are suitable, you should obtain expert advice.

Taxation
Levels and bases of, and relief's from, taxation are subject to change. *Please read the product prospectus carefully to ensure you understand how the investment product is taxed and how this may affect your personal tax position.*

This guide is intended as an overview of the subject of IHT and as such is only a short précis of the HMRC and Financial Planning rules and exemptions; it is not a personal recommendation.

Before proceeding with any IHT planning, professional advice should be sought as relevant. e.g. HM Revenue and Customs, solicitor, accountant, financial adviser.

This guide is based on our understanding of taxation, regulations and policies.However, the rules,the bases of, and the reliefs from, taxation my change or cease in the future.

Whitechurch Securities Limited is authorised and regulated by
the Financial Services Authority
Registered office: Arclight House, 3 Unity Street, Bristol, BS1 5HH

Tel: 0117 373 0400
E-mail: info@whitechurch.co.uk
Website: www.whitechurch.co.uk

This document has been prepared by the Investment Team of Whitechurch Securities Ltd which is the sister Company of The Whitechurch Network Ltd. Nexus Financial Planning is an appointed representative of The Whitechurch Network Ltd which is authorised and regulated by the Financial Services Authority.

Any views and opinions expressed are those of Whitechurch Securities Ltd and the intention of this document is to provide a guide to IHT planning.
The FSA does not regulate will writing services or taxation planning and advice