



Building Success

INHERITANCE TAX PLANNING

Planning to minimise the liability to IHT is a team effort involving you and your professional adviser. To enable long-term objectives to be set, it is necessary to make decisions about your finances and your family. Currently only 6% of estates have a liability to IHT. This is forecast to increase substantially in the next five years.

When should I plan for IHT?

Now! IHT is currently payable where a person's wealth is in excess of £300,000 for 2007/08. Thus, if you own your own house and have some savings, life assurance policies, or business assets, your estate could be liable.

Why now?

Most gifts made during your lifetime will be entirely exempt from IHT if you live for seven years after making the gift.

How does IHT work?

When you die, IHT will be charged on your personal wealth, together with all or a proportion of your lifetime gifts made in the preceding seven years.

The full rate of tax is 40%, but this is reduced on a sliding scale for gifts made between three and seven years before your death.

What do I need to consider?

You must think about the following:

1. The value of your assets now, and how this may change as time goes by
2. Your own financial security
3. Your family's future needs

What about my financial security?

You need to make sure that you and your spouse are properly provided for, particularly in retirement. It would not make sense to give assets to your children only to find that in later life you need to ask for some or all of them back!

And what about my family?

You need to think about what degree of control you would want your children to have over any assets you may transfer to them.

You also need to work out how much your spouse would need if you were to die first. This would, of course, have to be reflected in your Will.

In addition, you need to find out the intentions of parents or elderly relatives about their own assets.

How does IHT affect my business?

In general, a business you control will attract business property relief of 100%. In other words, your business can be passed on with no IHT being paid.

Assets owned by you but used by a partnership in which you are a partner, or a company you control, attract business property relief of 50%.

Similar reliefs apply to agricultural property.

What can I do to reduce the IHT bill?

1. Transfers of assets between spouses and civil partners are exempt from IHT, but other lifetime gifts may be more tax-efficient.
2. Lifetime gifts are potentially exempt from IHT, and there is no limit on such transfers, so this is an excellent way of transferring assets that you do not need to keep in your estate. It may be advisable to cover substantial gifts by insurance against death within seven years.
3. Trusts let you transfer assets out of your estate for IHT purposes, but enable trustees to exercise some degree of control over the capital or income (and you can be a trustee). There may be an IHT charge, but this would be at 20%, and then only if the transfer is over £300,000 for 2007/08.
4. Life assurance policies (unless designed to cover IHT liabilities) should be assigned during your lifetime so that the proceeds do not form part of your estate on death. The most common assignees are spouses, family members, and trusts.

Conclusion

We are living in an age of IHT planning opportunity. What you do is your decision, but the sooner you enlist our help the better. Remember, successful IHT planning has to be a team effort.

Does your Estate Planning Pass the Test?

It is never too early to plan your estate. If it is large, it could be exposed to inheritance tax at 40%, and if it is small, advance planning can help you ensure that your assets will go to your chosen beneficiaries. Currently only 6% of estates have a liability to IHT. This is forecast to increase substantially in the next five years.

Making a Will

Estate planning begins with the following decisions:

- Who will inherit your assets?
- When should the recipients receive them?
- What limitations will be placed on the recipients?

A will should also stipulate who is to be your minor child(ren)'s guardian. Although making a will makes your decision legally binding, the will can be amended any time you change your mind.

Where should you begin?

Start by completing the following survey. Every 'no' answer indicates an area where estate planning issues should be addressed.

1. Have you made a Will?
2. Has your Will been safely lodged so that others can access it after your death?
3. Does your Will name a guardian for your children if both you and your partner die while they are still in their minority?
4. Have you considered how to fund the inheritance tax liability?
5. If you die suddenly, will your executors be able to locate all your records easily?
6. Do you have medium-term and long-term financial objectives?
7. Do you know the present value of your estate?
8. Are you comfortable with the executor(s) and trustees you have selected?
9. Have you arranged your affairs to take advantage of the NIL rate band and the inheritance tax exemptions?
10. Are you sure you have the right type and amount of life assurance?
11. Have you considered a trust to prevent assurance proceeds from being taxed as part of your estate?
12. Have you considered making gifts to family members that take advantage of the inheritance tax and capital gains tax exemptions and reliefs?
13. Are you sure your estate plan is up-to-date and takes into account all your personal wishes and all your potential tax saving strategies?
14. Have you considered how inheritance tax will affect your business?
15. Do you know what will happen to your business if you die?
16. Do you know that business assets can be given away without your having to pay capital gains tax?
17. Do you know how to give away business assets free of inheritance tax?

18. Have you considered the use of trusts in estate planning?
19. Do you know the advantages of an accumulation and maintenance trust?
20. Do you know the intentions of relatives with substantial estates?

DISCRETIONARY TRUST WILLS

With property prices near an all-time high, and most mortgages carrying a life insurance policy meaning that the mortgage is paid off at death, a large number of married couples now have a joint estate worth well in excess of the current Inheritance Tax (IHT) threshold of £300,000. Without proper planning, a large IHT liability can be incurred when the estate is finally passed on to the children. For an estate worth £600,000, that liability would be approximately £120,000.

There **is**, however, a way in which married couples can minimise or even eliminate the IHT liability simply by making and implementing a pair of correctly worded Wills - known as Discretionary Trust Wills and sometimes referred to as Nil-Rate Band Discretionary Trust Wills.

How do Discretionary Trust Wills work?

Discretionary Trust Wills work by making use of the Nil-Rate band (£285,000) of **both** spouses, rather than just that of the surviving spouse (as would normally be the case).

For ease of explanation, in the example below, it will be assumed that the husband dies first. However, the rules are exactly the same if the husband lives the longer. We will also assume, for simplicity, that the IHT Threshold is at the 2002 level (£250,000 - it has since increased).

Assume that a husband and wife each have an estate of £250,000. They wish to give everything to the survivor when the first one dies, and on the second death they wish everything to go to their children.

On the husband's death he gives all his property to his wife (when addressing the issue of IHT, "property" means everything of value including money, shares, buildings, land, business interests etc). No Inheritance Tax is payable on the husband's death as there is an IHT exemption for property passing between spouses.

On the wife's death, she leaves all her property to the children. For arguments sake we shall assume that her estate now consists of her own £250,000 plus the £250,000 she inherited from her husband, a total of £500,000.

Assuming the rates haven't changed, the first £250,000 would be taxed at the "nil-rate" with the remainder being taxed at 40%. This gives an Inheritance Tax liability on her death of £100,000.

If, instead of leaving his £250,000 to his wife, the husband had left it directly to the children, then on his death there would still be no tax payable as his estate would be

within the current nil-rate band. On the wife's death her estate would amount to £250,000 and would again be free of tax. The result of making use of the husband's nil-rate band by passing assets directly to the children would therefore give rise to an Inheritance Tax saving of £100,000.

Passing assets directly to the children on the first death is fine in theory, but it does mean that the wife may be left short of money following her husband's death, she may even have to sell the marital home, and she would have no control over the money held by the children. The risk of making use of the nil-rate band on the husband's death (by passing his estate to the children) may therefore be deemed to be too great.

There is, however, a way to make use of the nil-rate band on the husband's death whilst still permitting the wife to continue to benefit from, and control, his estate. This is achieved by using the Nil-Rate Band Discretionary Trust.

Instead of leaving £250,000 directly to the children, the husband, by his Will, leaves it to the trustees of a purpose made "discretionary trust". The wording of the Trust would permit the £250,000 in the Trust to be - instead of money or property worth £250,000 - a charge on a property or a promise of payment from the wife, or alternatively for the wife to borrow or draw income from the Trust. Thus - and this is important if most of the estate is tied up in the marital home - the wife is not left short of money and the marital home does not have to be sold.

Because the capital from the husband's estate has been passed to a discretionary trust and not to the wife, it will be outside of her estate and will not be taxable on her death.

When she dies her own estate will still only amount to £250,000 and, therefore, be tax-free.

Thus, the Inheritance Tax liability is still reduced from £100,000 to nothing, but without the hardship and inconvenience suffered by the wife were she only to inherit £250,000.

The above example should give you a general idea of what Discretionary Trust Wills are all about, and whether or not such Wills would be beneficial to you. As a rule of thumb, if you are married and your house is worth more than £300,000 then they probably would.

Obviously, there are issues to consider - not least of which is the fact that we offer more than one type of Discretionary Trust Will, each one dealing with a different set of circumstances. There are also sometimes disadvantages to making a Discretionary Trust Will - but they are normally heavily outweighed by the IHT saving.

Inheritance tax rates

The following inheritance tax rates apply.

Rates	2007/2008	2006/2007
Nil rate band	up to £300,000	up to £285,000
Chargeable at 40%	above £300,000	above £285,000

A Potentially Exempt Transfer (PET) normally has IHT due if death occurs within seven years of the gift being made.

Tax is charged at 20% where tax is payable on a lifetime gift (other than those taxable only because they are made within seven years of death).

Inheritance tax relief

The following inheritance tax taper relief is available.

Time from gift to death	Reduction in tax payable on PET
0 to 3 years	nil
3 to 4 years	20%
4 to 5 years	40%
5 to 6 years	60%
7 years or over	100%

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