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## David Beckman & Co Ltd

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### INHERITANCE TAX

#### 1. What is Inheritance Tax (IHT)?

IHT is a tax charged on the value of assets you own when you die (your estate). IHT is also charged on certain gifts made during your lifetime. These may be gifts made within seven years before your death or transfers to discretionary trusts.

#### 2. What is the scope of IHT?

A person domiciled in the UK is subject to IHT on all assets, whether they are situated here in the UK or abroad. A person domiciled outside the UK is subject to IHT only on assets situated in the UK. Domicile is a legal concept which is distinct from residence. Residence relates to the country where you currently live. Generally, however, you are domiciled in the country with which you are most closely identified.

#### 3. What rate of tax applies?

Currently, the first £325,000 of a person's estate is exempt from tax (or more correctly taxed at 0%). This "Nil Rate Band" is usually increased annually in line with inflation.

It may seem that only the few rich people are affected by IHT. However, many could be facing an IHT liability as a result of the growth in value of their home, and a gradual increase in personal wealth.

#### 4. How can I reduce the amount of IHT Payable?

- a) **Make a will.** Many fail to do this, which can create problems for the surviving partner/spouse and the children. In the absence of a will, a surviving partner, as opposed to wife will not get anything. In the absence of a will, your estate will be distributed based on the laws of intestacy - see attached PDF file for how these laws work).
- b) **Gifts between husband and wife** are totally exempt from IHT, whether made on death through a will or during lifetime. The only exception to this is where the spouse receiving the gift is not domiciled in the UK, in which case generally only transfers up to the nil rate band of currently £325,000 are exempt, unless an irrevocable election is made to be treated as domiciled in the UK and thus subject to IHT on worldwide assets.

A man and woman are deemed to be husband and wife for IHT purpose until they are divorced. (For income and capital gains tax it is until separated).

#### **Gifts between a man and woman who are not married are not exempt from IHT.**

If all the assets pass on death to the surviving spouse, prior to 6 April 2008, this could leave a substantial IHT liability on the death of the second spouse. This is because the first spouse's exemption/nil rate band has been wasted. Since 6 April 2008, the unused nil rate band from the first partner's death can be used when the



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second partner dies. You may need to revisit wills in the light of this change to consider making legacies to children of certain assets or using discretionary trusts.

- c) Any gifts up to the nil rate band are free from IHT.
- d) Certain other Gifts made during your lifetime** are totally exempt from IHT:
- (i) Gifts up to £3,000 per year. If you only use part of this exemption in a tax year, the remainder can be carried forward to the next year.
  - (ii) Small gifts up to £250 to as many people as you wish.
  - (iii) Each parent can give £5,000 to a child on the occasion of the child's marriage (other relatives can give £2,500 as a marriage present).
  - (iv) Gifts made out of normal surplus income. This is an extremely useful exemption if a regular pattern of giving can be established. We recommend that a document (which we can provide) is put in place each year to support this relief.
  - (v) Gifts to charities and political parties.
  - (vi) Any other gifts provided you are still alive seven years after the gift has been made. Should you die within seven years, the amount of tax that could become payable would be tapered or reduced as follows, depending on the length of time which elapses between the gift and dying:

<b>Donor Survives</b>	<b>%age of Tax Payable</b>
<b>0 – 3 years</b>	<b>100%</b>
<b>3 – 4 years</b>	<b>80%</b>
<b>4 – 5 years</b>	<b>60%</b>
<b>5 – 6 years</b>	<b>40%</b>
<b>6 – 7 years</b>	<b>20%</b>

## 5. Other Reliefs

### a) **Business Property Relief (BPR).**

100% relief may apply to interests in unincorporated businesses and all holdings of shares in unquoted trading companies. The property must invariably have been owned for the two years preceding the transfer.

50% relief is available for buildings or other assets owned by sole traders/partners or shareholders and used in their sole trades/partnerships/companies.

It is generally advisable to leave assets which are eligible for BPR directly to children or for their benefit in trust, rather than leaving them to the surviving spouse. This is in order to take advantage of the available BPR (otherwise BPR is wasted because the transfer to spouse is covered by the spouse exemption instead). Other considerations may be relevant so advice should always be sought.

### b) **Agricultural Property Relief (APR).**

100% or 50% relief may be available on some agricultural property depending on certain conditions. Again there is a minimum period required for holding the asset in order to qualify for the relief at all.

c) **Excepted Assets.**

BPR and APR is restricted where the business includes assets that have not been used wholly or mainly for the purposes of the business throughout the two years immediately preceding the transfer. This is to prevent people “parking” non-business assets in a business simply to attract the generous BPR/APR.

**6. Sophisticated Tax Planning**

Is it possible to reduce or eliminate altogether the IHT liability on the death of the second person, without totally depriving the surviving partner of access to monies from the deceased partner’s estate? The answer is “Yes”, using one of the following techniques:

- a) On the death of the first partner, a legacy of up to the nil rate band can be given to beneficiaries other than the surviving partner. You will, however, need to consider the financial needs of the surviving partner. Such a legacy would of course remove the amount given from the estate of the surviving partner. We work very closely with Zac our IFA partner to identify the extent to which giving assets away will not compromise your or your spouse’s lifestyle into the unknown future.
- b) Where a property is owned as tenants in common, the half share of the property (or a proportion of the value of a half share up to the nil rate band) could be left to the children on the first death. **See our separate fact sheet about the Residence Nil Rate Band – item 9 for the tax benefits of doing this with effect from 2017 onwards.** Other factors would obviously need to be considered as well if this route were pursued. It would be possible on the first death for the children to create a life interest trust of their interest in the property in favour of the surviving partner. This life interest trust would automatically come to an end on the death of the second partner and the half share of the property would revert immediately to the children. On the death of the second partner, only the share of the property owned by the surviving partner would be in their estate for IHT purposes.
- c) A discretionary will trust could be set up using the nil rate band. The surviving spouse would and the children /grandchildren could be one of the beneficiaries of such a trust. However, the use of a discretionary trust would mean that the residence nil rate band is not available from 2017 onwards. This option thus remains of benefit for estates worth more than £2.35M.
- d) The careful use of trusts generally can result in substantial IHT savings.
- e) It is possible but not easy to do IHT planning in respect of the **MAIN HOME**. **See too our separate fact sheet about the Residence Nil Rate Band which comes into place from 2017 onwards.** You have to overcome the problem caused by the surviving partner generally needing to carry on living in the house, which means you can very easily fall foul of the general anti-avoidance provision (Gift with Reservation of Benefit -GROB). GROB says that if you or your spouse continue to benefit in any way from a gifted asset, the gift is disregarded – the gift is thus totally ineffective and the value of the gifted asset remains within your estate subject to IHT.

There are a variety of options, all of which are mainstream and legitimate ways of avoiding IHT and cannot be attacked by HMRC as “abusive” if dealt with correctly. In the case of strategies involving a gift, rather than sale, the donor needs to survive seven years for the value to completely escape IHT.

- (i) Gift followed by Rent – the husband and wife gift the main home to the children. There should be no CGT on the gift due to principal private residence relief. There should also be no stamp duty land tax (SDLT) as it is a gift. The parents do however have to pay a full market value rent to the children for the rest of their lives for the occupation of the property. Generally, you need to obtain two independent valuations for a market rent.

This works best where the parents generally have sufficient income to be able to afford a market rent. The rental income is taxable in the hands of the children at their marginal tax rate. The children are liable to CGT as and when the property is sold.

- (ii) Gift followed by the buy back of the right to occupy – the parents gift the main home to the children, pay a full market rent for say just 3 months to the children for occupying the property. Then two independent actuarial valuations are obtained for the parents' right to occupy the property for the rest of their lives. This value of the right to occupy will be substantially lower than the actual value of the freehold value of the house that has been gifted. The parents pay the child/children the agreed value for the right to live in the house for the rest of their lives as a single lump sum. The children pay income tax on this income which is treated as Land & Property Income.
- (iii) Sale by one spouse to the other, alongside an IOU note – One spouse sells to the other at full market value for the house. The spouse who sells takes an IOU from his spouse for the full value. There should be no CGT to pay on the sale due to the spouse exemption. However, the one downside is that SDLT is payable of the sale based on the full market value. A little time later, the selling spouse who holds the IOU note gifts this to the children with the result that the money which would otherwise come into the selling spouse's estate upon death of the buying spouse, now escapes the estate and IHT, provided, s/he survives seven years.
- (iv) The gift of the main home into joint names with one child or more, where the child to whom the half share is gifted then occupies the property with the parent for the rest of the life of the parent. This works where it is acceptable or necessary for a child to remain living in the family home as an adult. If the child does move out for any reason at any time, the donor parent must start to pay a commercial rent to the child from that point for the rest of his/her life.

## **7. Whole of Life Insurance Policy**

Using a whole of life assurance policy is one of the simplest ways of providing a cash to meet any IHT bill. Upon your death, a cash lump sum will be payable to meet the IHT bill.

The life policy needs to be written in trust to ensure that the proceeds fall outside your estate and are, therefore, not liable to IHT. Different types of policies are available to suit your specific requirements. The amount of cover you take out will depend on the level of cover required (based on the expected IHT bill) and obviously the cost. As life policies are costed to take into account your age, the earlier you take out such a policy the cheaper the premiums will be.

A factor to consider though is the opportunity cost you've lost paying premiums for life cover compared to the value of this money over say 20-30 years if you'd invested it in other ways.

This information is for general guidance only. We strongly recommend that you take specific advice before acting based on the above, as IHT is complex and there can be many pitfalls.

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