

Guidance Note - Inheritance Tax

Use your exemptions before it's too late

There are many ways for families to reduce their IHT liability. We review the exemptions available. The recent rise in property values has brought many people into the inheritance tax (IHT) net and last year, the Government earned over £3.5bn from IHT, an increase of almost 50% in just five years.

So how can families reduce their liability?

Make gifts

Certain gifts will fall out of an estate immediately, while others will remain chargeable for up to seven years. The main exemptions are summarised in Figure 1.

Keep life insurance proceeds out of the estate

Life insurance policies should always be held in trust so that death benefits fall outside the estate and can be accessed without probate.

Review wills

All adults should have a will, which should be reviewed regularly, particularly as children grow older. It should also be noted that marriage or divorce voids previous wills. Beneficiaries can change a will by mutual consent up to two years after death, which is a useful planning tool.

Equalise estates

Spouses should make sure that they each own sufficient assets to use their respective nil-rate bands on death if they are transferring funds to others.

Include a nil-rate band discretionary trust in wills

A nil-rate band discretionary will trust allows spouses to settle assets up to the nil-rate band, giving the survivor access to the assets without them falling into their estate. This potentially saves £120,000 in IHT, although the trust must be carefully managed to secure the IHT saving.

Equity release

Elderly people may have considerable value tied up in their home and many are turning to equity release schemes as a way of unlocking funds which, in turn, can be gifted. There are two main types of equity release. The first is a lifetime mortgage, which is secured against the value of the home and can be released as a lump sum or regular income. The second is a reversion scheme, whereby a proportion of the property is sold to an investment company, but the seller can stay in the property rent-free as long as they wish.

Such schemes need to be looked at carefully and may only be suitable in certain limited circumstances. But they can be useful planning tools.

AIM shares and portfolios

Shares listed on AIM are 'unquoted' for IHT purposes, which means that shares held in AIM trading companies are not liable to IHT once they have been held for two years. Life insurance is available to cover the interim two-year period. AIM portfolios that include a broad range of shares to reduce risk are becoming a popular way of tackling IHT.

Discounted gift schemes

Discounted gift schemes immediately reduce the value of an estate and further savings can be made if the individual survives for seven years. Such schemes can be used up to the age of 90.

Specific IHT-saving schemes

One IHT-saving scheme on the market effectively allows people to swap their home for units in a life insurance fund, which can be gifted while they remain in the property. These are quite flexible schemes, but expert advice is recommended.

Agricultural and business property

Assets, such as an office or working farm (including perhaps a farmhouse), may fall outside the IHT net once they have been owned for two years.

Works of art and heritage property

Pre-eminent works of art and heritage property may be exempt from IHT if members of the public are allowed to view them. Furthermore, some assets can be used to settle IHT liabilities.

Other gifts

Finally, gifts to registered charities can be made free of IHT and, interestingly, so can gifts to political parties.

Fig 1: A summary of the main gifts exempt from IHT

Gifts exempt from IHT	Value	IHT Saving	Comments
Annual Gift	£3,000	£1,200	An individual can give away £3,000 annually or £6,000 if no gift was made the previous year.
Small Gifts (unlimited number)	£250 to each donee	£100 per gift	Unlimited gifts of £250 a year to different people, which must not form part of a larger gift.
Wedding Gifts (including civil partnerships)	£5,000	£2,000	From parent to child.
	£2,500	£1,000	To grandchildren or great grandchildren.
	£1,000	£400	To anyone else getting married.
Gifts to Spouses (including civil partners)	Unlimited	40% of gift	There is a limit of £55,000 on the IHT-free gift when that gift is from a domiciled to a non-domiciled spouse.
Regular Gifts From Income	Unlimited	40% of gift	Gifts must be from surplus income, be habitual and should be documented.
Lifetime Gifts to Individuals (potentially exempt transfer)	Unlimited	40% of gift after seven years	As the donor must survive for seven years after the gift is made, it is important to record the date of the gift.

If you would like to arrange a free no obligation meeting to discuss reducing your IHT liability, please contact John Lang - Director, Tower Hill Associates Limited on 020 8891 6375.

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