

Inheritance Tax Planning

Tax exemption

With the rise in property values, Inheritance Tax is now affecting more and more people. It is not just a tax on death – it can affect gifts made during lifetime as well. That's the bad news – the good news is that, with sensible planning, Inheritance Tax can almost become a voluntary tax.

Gifts made in lifetime can become free of tax with the passage of time. In any event, each individual has an annual allowance and there are several other forms of gifts which are exempt.

A proportion of every individual's estate is tax free (called the "nil rate band") and that proportion is set each year in the Chancellor's Budget. Property passing to certain beneficiaries (ie your spouse and charities) is exempt.

Business property, timber and agricultural property may also be wholly or partially exempt.

Your liability

When you die, after taking account of exempt property, Inheritance Tax is charged at 40% on any assets or property above the nil rate band. Gifts made in the seven years before your death will also be included in the calculation of Inheritance Tax after the deduction of various lifetime allowances and exemptions.

In other words, the Chancellor of the Exchequer can receive forty pence in the pound on a significant proportion of your Estate unless you have taken some action to avoid this.

"Normal" wills

If you are married and make the "normal" type of Will - on the first death, everything passes to the surviving spouse and, on the second death, to your children or other members of your family – there is initially no problem, as all the property will be exempt on the first death from Inheritance Tax. However, on the second death, the combined estate passing to the family will all be chargeable to Inheritance Tax save for the nil rate band.

Double exemption

If on the other hand, the first of you to die had left his/her nil rate band direct to the children, the combined Estate on the second death would be that much less, and the survivor's nil rate



"£100,000!! For your family or the Chancellor!"

band might well exceed his or her estate and thus avoid Inheritance Tax. In other words, a "double exemption" would have been achieved with a tax difference to the children of something in the region of £100,000 (assuming the figures worked to maximum advantage). That means a direct additional £100,000 paid to your children or other beneficiaries.

Discretionary trust

Most couples are not in a position to leave substantial assets to their children on the first death. This is most obvious when the main asset of the family is the family home. Fortunately, there is a way of "having your cake and eating it". Instead of leaving the nil rate band to the children, it can be left to a "discretionary trust".

A discretionary trust is where a fund is left in the hands of Trustees for the benefit of a wide class of beneficiaries but it is left to the Trustees to determine who gets what (if anything) from time to time. When planning a tax efficient Will,



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its beneficiaries would normally be the surviving spouse, children, grandchildren etc. The Trustees can be the surviving spouse, or one or more other people (there must be at least one other trustee), and it would be useful as well if the other Trustees could be counted upon not to contradict the wishes of the surviving spouse.

Co-trustees

If your children are of age, they can be included as Trustees if you feel this would be appropriate. However, there may be a case for having an independent co-Trustee. In any event, you must be sure that the Trustees have the best interests of the surviving spouse at heart.

The surviving spouse could draw most of the income from the Trust but consideration must also be given to making payments to other beneficiaries to show to all the world (and, in particular, the Inland Revenue) that the Trust remains discretionary by nature.

However, the Trustees can also be given the power to satisfy the legacy due to them by means of a debt payable by the surviving spouse. This means that all assets in your Estate could pass to the surviving spouse to use as he or she sees fit but with a debt to reduce the Estate of the surviving spouse for tax purposes in addition to his or her own nil rate band. When the debt is repaid, perhaps on the death of the surviving spouse, the money can be distributed to the children or as circumstances at the time might dictate.

The use of such a Trust is very flexible and, provided certain guidelines are observed, the scheme is acceptable to the Inland Revenue.

Joint property

To be effective, the scheme outlined above requires that, on the first death, assets fall into that estate up to the value of the nil rate band or beyond. There can be complications if you and your spouse's assets are held in joint names, particularly the family home. If assets are held as "joint tenants" they will pass to the joint owner outside the provisions of your Will and therefore negate or reduce the effectiveness of the tax saving trust. We can explore with you the nature of your assets and the form of joint ownership – we can also prepare the necessary documents to ensure that any tax saving trust in your Will is given full effect.



“There are always traps for the unwary.”

Our assistance

As with all taxes, inheritance Tax planning is a complicated matter with traps for the unwary and requiring much expertise. We have many years of experience in this field and would be very happy to discuss matters with you in more detail, either when taking your instructions for a Will or in connection with general tax and financial planning.



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