INDEPENDENT
Financial Management

A Guide to Inheritance Tax Planning

Preserving and Passing your wealth

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A Guide to Inheritance Tax Planning

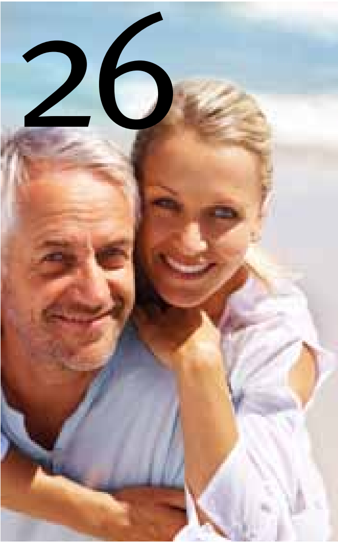
Welcome to our guide to Inheritance Tax, dedicated to helping you mitigate the potential effects of Inheritance Tax on your estate, whether you are considering the use of family trusts or alternative solutions. Your wealth might encompass businesses, property and investments in the UK and abroad that require specialist considerations.

Helping you protect your wealth is an important part of what we do, and one thing is certain, you need to plan to protect your wealth from a potential Inheritance Tax liability. Benjamin Franklin once said that 'nothing is certain but death and taxes', and thanks to Inheritance Tax, they're not only certain, they're intrinsically linked. Once only the domain of the very wealthy, the wide-scale increase in home ownership and rising property values over the past decade have pushed many estates over the Inheritance Tax threshold.

Inheritance Tax applies to your entire worldwide estate, including your property, savings, car, furniture and personal effects. You should also consider all of your investments, pensions and life insurance policies and ensure that life polices are held in an appropriate trust so they do not add to the value of your estate.

Inheritance Tax as we know it today was introduced in 1986. The current rate of Inheritance Tax for everyone is charged at 40 per cent, and is paid by those who inherit. It is deducted from your estate on death, so Inheritance Tax is relevant whether you stand to gain an inheritance or plan to leave one.

If you would like to discuss the options available to you for protecting your legacy, please contact us for further information. We can help you with the many aspects of Inheritance Tax Planning, from advice on wills and trusts to other tax-efficient ways to ensure your wealth is best structured for your beneficiaries.



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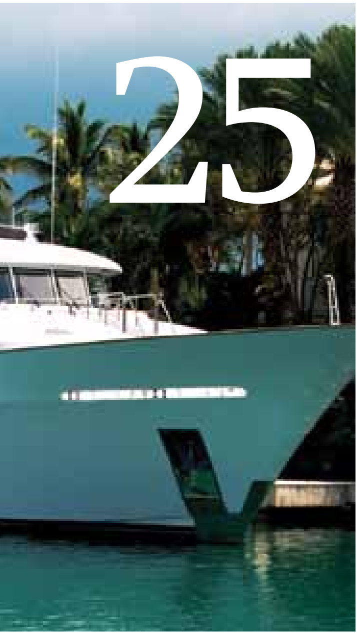

Contents...

Dispelling the myth about Inheritance Tax 06
Protecting wealth from a potential liability.

Transferring wealth between your spouse or civil partner 08
New rules could mean up to double the Inheritance Tax allowance is available.

Inheritance Tax matters 09
Leaving your assets.

Legal documents 10
Applying for probate.

Making a will 11
Will your estate be shared out exactly as you want it to be?

Valuing an estate 12
Accurately reflecting what those assets would receive in the open market.

Financial reasons to make a will 14
Putting it off could mean that your spouse receives less.

Alternative Investment Market shares 16
Reducing an Inheritance Tax liability on an estate.

Minimising an Inheritance Tax liability 17
Passing assets to beneficiaries using a trust.

Important exemptions 20
Legally passing on your estate without it being subject to Inheritance Tax.

A gift with reservation 22
Making sure the gift is not a gift for Inheritance Tax purposes.

Arranging to pay Inheritance Tax 23
Who will handle your affairs?

Protecting your wealth 24
Making the most of different solutions.

Inheritance Tax glossary 26
Common estate planning terms.

Dispelling the myth about Inheritance Tax

Protecting wealth from a potential liability

Inheritance Tax is the tax that is paid on your 'estate', chargeable at a current rate of 40 per cent. Broadly speaking, this is a tax on everything you own at the time of your death, less what you owe. It's also sometimes payable on assets you may have given away during your lifetime. Assets include property, possessions, money and investments. One thing is certain, careful planning is required to protect your wealth from a potential Inheritance Tax liability.

Not everyone pays Inheritance Tax on their death. It only applies if the taxable value of your estate (including your share of any jointly owned assets and assets held in some types of trusts) when you die is above £325,000 (2009/10 tax year). It is only payable on the excess above this nil rate band.

There are also a number of exemptions which allow you to pass on amounts (during your lifetime or in your will) without any Inheritance Tax being due, for example:

- if your estate passes to your husband, wife or civil partner and you are both domiciled in the UK there is no Inheritance Tax to pay, even if the estate is above the £325,000 nil rate band
- most gifts made more than seven years before your death are exempt
- certain other gifts, such as wedding gifts and gifts in anticipation of a civil partnership up to £5,000 (depending on the relationship between the giver and the recipient), gifts to charity and £3,000 given away each year are also exempt

Transfers of assets into most trusts and companies will become subject to an immediate Inheritance Tax charge if they exceed the Inheritance Tax nil rate band (taking into account the previous seven years' chargeable gifts and transfers).

In addition, transfers of money or property into most trusts are also subject to an immediate Inheritance Tax charge on values that exceed the Inheritance Tax nil rate band. Tax is also payable ten-yearly on the value of trust assets above the nil rate band; however certain trusts are exempt from these rules.

In order to work out whether the current Inheritance Tax nil rate band of £325,000 (tax year 2009/10) has been exceeded on a transfer, you need to take into account all 'chargeable' (non-exempt, including potentially exempt) gifts and transfers made in the previous seven years. If a transfer takes you over the nil rate band, Inheritance Tax is payable at 20 per cent on the excess.

Where the transfer was made after 5 April and before 1 October in any year, the tax is payable on 30 April in the following year. Where the transfer was made after 30 September and before 6 April in any year, it is payable six months after the end of the month in which the transfer was made.

On 22 March 2006, the government changed some of the rules regarding trusts and introduced some transitional rules for trusts set up before this date. Trusts not affected by the new rules (and so where no Inheritance Tax is immediately payable on any transfers, but with regard to transfers made during someone's lifetime may be payable if the individual dies within seven years) are:

- lifetime transfers into a trust for a disabled person
- trusts created on death for a disabled person
- trusts created on death for a minor child of the deceased in which the child will become fully entitled to the assets at age 18
- trusts set up under a will for someone who is not a disabled person or minor child of the deceased who becomes entitled to their benefit on the death of the person who wrote the will

Inheritance Tax is the tax that is paid on your 'estate,' chargeable at a current rate of 40 per cent. Broadly speaking this is a tax on everything you own at the time of your death, less what you owe.

Existing accumulation and maintenance trusts had until 6 April 2008 to change (where appropriate) the trust's rules to enable them to fall outside the new rules.

Interest in possession (IIP) trusts that existed before 22 March 2006, or which replaced a pre-March 2006 IIP up to 5 October 2008, continue to benefit from the old rules until they come to an end. All other newly created IIP trusts will come under the new rules.

If you die within seven years of making a transfer into a trust on which you have already paid 20 per cent Inheritance Tax, the tax due is recalculated using the Inheritance Tax rate applicable on death (currently 40 per cent). Tax will be payable by your estate to HM Revenue & Customs on the difference.

If you made a transfer on which no Inheritance Tax was due at the time, its value is added to your estate when working out any Inheritance Tax that might be due.

Trusts that count as 'relevant property trusts' must also pay:

- a 'periodic' tax charge of up to 6 per cent on the value of trust assets over the Inheritance Tax nil rate band once every ten years
- an 'exit' charge proportionate to the periodic charge when funds valued above the Inheritance Tax nil rate band are taken out of a trust between ten year anniversaries

These rules don't apply to trusts which are exempt from the new rules.

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Transferring wealth between your spouse or civil partner

New rules could mean up to double the Inheritance Tax allowance is available

New rules mean that the survivor of a marriage or civil partnership can benefit from up to double the Inheritance Tax allowance (£650,000 for 2009/10 tax year, increasing to £700,000 by 2010/11), in addition to the entitlement to the full spouse relief.

Inheritance Tax is only paid if the taxable value of your estate when you die is over £325,000 (2009/10 tax year). The first £325,000 of a person's estate is known as the Inheritance Tax nil rate band because the rate of Inheritance Tax charged on this amount is currently set at zero per cent, so it is free of tax.

Where assets are transferred between spouses or civil partners, they are exempt from Inheritance Tax. This can mean that if, on the death of the first spouse or civil partner, they leave all their assets to the survivor, the benefit of the nil rate band to pass on assets to other members of the family, normally the children, tax free is not used.

> Where one party to a marriage or civil partnership dies and does not use their nil rate band to make tax-free bequests to other members of the family, the unused amount can be transferred and used by the survivor's estate on their death.

Where one party to a marriage or civil partnership dies and does not use their nil rate band to make tax-free bequests to other members of the family, the unused amount can be transferred and used by the survivor's estate on their death. This only applies where the survivor died on or after 9 October 2007.

In effect, spouses and civil partners now have a nil rate band that is worth up to double the amount of the nil rate band that applies on the survivor's death.

Inheritance Tax matters

Leaving your assets

If you leave everything to your husband, wife or civil partner, in this instance there usually won't be any Inheritance Tax to pay because a husband, wife or civil partner counts as an 'exempt beneficiary'. But bear in mind that their estate will be worth more when they die, so more Inheritance Tax may have to be paid then.

However, if you are domiciled (have your permanent home) in the UK when you die but your spouse or civil partner isn't, you can only leave them £55,000 tax-free.

Other beneficiaries

You can leave up to £325,000 tax-free to anyone in your will, not just your spouse or civil partner (tax year 2009/10). So you could, for example, give some of your estate to someone else or a family trust. Inheritance Tax is then payable at 40 per cent on any amount you leave above this.

UK Charities

Inheritance Tax isn't payable on any money or assets you leave to a registered UK charity – these transfers are exempt.

Wills, trusts and financial planning

As well as making a will, you can use a family trust to pass on your assets in the way you want to. You can provide in your will for specific assets to pass into a trust or for a trust to start once the estate is finalised. You can also use a trust to look after assets you want to pass on to beneficiaries who can't immediately manage their own affairs (either because of their age or a disability).

You can use different types of family trust depending on what you want to do and the circumstances. If you are planning to set up a trust you should receive specialist advice. If you expect the trust to be liable to tax on income or gains you need to inform HM Revenue & Customs Trusts as soon as the trust is set up. For most types of trust, there will be an immediate Inheritance Tax charge if the transfer takes you above the Inheritance Tax threshold. There will also be Inheritance Tax charges when assets leave the trust.

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Legal documents

Applying for probate

If you are an executor of someone's will, you may need a legal document called a 'grant of probate' to enable you to sort out the deceased person's affairs. If there is no will, a close relative can apply for a 'grant of letters of administration'. In Scotland different procedures apply for a death.

If there is more than one executor it's common to agree that one will apply for the grant and sort out the will. However, up to four executors can apply jointly and sort out everything together.

You can ask a solicitor to apply for the grant for you. There may be a charge to provide this service, so it's a good idea to check first.

If you apply for probate without a solicitor, the forms you need to complete depend on where the person lived and whether or not you expect Inheritance Tax to be due on the estate. Inheritance Tax is only paid in a small number of cases, when the taxable value of the deceased person's estate (after exemptions) is over the £325,000 threshold (applies for deaths in the 2009/10 tax year).

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Making a will

Will your estate be shared out exactly as you want it to be?

Planning your finances in advance should help you to ensure that when you die everything you own goes where you want it to. Making a will is the first step in ensuring that your estate is shared out exactly as you want it to be.

If you don't make a will, there are rules for sharing out your estate called the Law of Intestacy, which could mean your money going to family members who may not need it, or your unmarried partner or a partner with whom you are not in a civil partnership receiving nothing at all.

If you leave everything to your spouse or civil partner there'll be no Inheritance Tax to pay because they are classed as an exempt beneficiary. Or you may decide to use your tax-free allowance to give some of your estate to someone else or to a family trust.

A will sets out who is to benefit from your property and possessions (your estate) after your death. There are many good reasons to make a will:

- you can decide how your assets are shared – if you don't have a will, the law says who gets what
- if you're an unmarried couple (whether or not it's a same-sex relationship), you can make sure your partner is provided for
- if you're divorced, you can decide whether to leave anything to your former partner
- you can make sure you don't pay more Inheritance Tax than necessary

Before you write your will, it's a good idea to think about what you want included in it. You should consider:

- how much money and what property and possessions you have
- who you want to benefit from your will
- who should look after any children under 18 years of age
- who is going to sort out your estate and carry out your wishes after your death – in other words, your executor

An executor is the person responsible for passing on your estate. You can appoint an executor by naming them in your will. The courts can also appoint other people to be responsible for doing this job.

Once you've made your will, it is important to keep it in a safe place and tell your executor, close friend or relative where it is.

It is advisable to review your will every five years and after any major change in your life, such as getting separated, married or divorced, having a child or moving house. Any change must be by 'codicil' (an addition, amendment or supplement to a will) or by making a new will.

Scottish law on inheritance differs from English law.

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Valuing an estate

Accurately reflecting what those assets would receive in the open market

When valuing a deceased person's estate, you need to include assets (property, possessions and money) they owned at their death and certain assets they gave away during the seven years before they died. The valuation must accurately reflect what those assets would reasonably receive in the open market at the date of death.

Valuing the deceased person's estate is one of the first things you need to do as the personal representative. You won't normally be able to take over management of their estate (called 'applying for probate' or sometimes 'applying for a grant of representation/ confirmation') until all or some of any Inheritance Tax that is due has been paid.

But bear in mind that Inheritance Tax is only payable on values above £325,000 for the 2009/10 tax year.

The valuation process

This initially involves taking the value of all the assets owned by the deceased person, together with the value of:

- their share of any assets that they own jointly with someone else – for example, a house that they own with their partner
- any assets that are held in a trust, from which they had the right to benefit
- any assets which they had given away, but in which they kept an interest – for instance, if they gave a house to their children but still lived in it rent-free
- certain assets that they gave away within the last seven years

Next, from the total value above, deduct everything that the deceased person owed, for example:

- any outstanding mortgages or other loans
- unpaid bills
- funeral expenses

(If the debts exceed the value of the assets owned by the person who has died, the difference cannot be set against the value of trust property included in the estate.)

The value of all the assets, less the deductible debts, gives you the estate value. The threshold above which the value of estates is taxed at 40 per cent is £325,000 for the 2009/10 tax year.

If you don't know the exact amount or value of any item, such as an Income Tax refund or household bill, you can use an estimated figure. But rather than guessing at a value, try to work out an estimate based on the information available to you. You'll find instructions about how to show estimates on the form you complete.

The forms on which you'll need to record the valuation will differ, depending on the expected valuation amount. You complete a form IHT205 for estates where you don't expect to have to pay Inheritance Tax (called 'excepted estates') and a form IHT400 where you do expect to have to pay. The forms vary for excepted estates in Scotland.

You should be able to value some of the estate assets quite easily, for example, money in bank accounts or stocks and shares. In other instances, you may need the help of a professional valuer (or chartered surveyor for valuing a property). If you do decide to employ a valuer, make sure you ask them to give you the 'open market value' of the asset. This represents the realistic selling price of an asset, not an insurance value or replacement value.

If the affairs of the estate are complicated, you may want to work with a solicitor to help you value the estate and pay any tax due. If you're not using a solicitor you can ask HM Revenue & Customs to use form IHT400 to work out any Inheritance Tax due.

Once you've completed the relevant tax forms, you also need to complete the relevant probate form.

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Paying Inheritance Tax - forms you need to complete

Country in which the deceased person lived	Required forms if Inheritance Tax is unlikely to be due ('excepted estates')	Required forms if you expect Inheritance Tax to be due
England or Wales	Probate application form PA1 Inheritance Tax form IHT205	Probate application form PA1 Inheritance Tax form IHT400 Form IHT421 'Probate summary'
Scotland	Form C1 ('Inventory') and form C5 if they died on or after 6 April 2004; otherwise form C1 only	Form C1 ('Inventory') Inheritance Tax form IHT400
Northern Ireland	Inheritance Tax Form IHT205 only	Inheritance Tax form IHT400 Form IHT421 'Probate summary'

Financial reasons to make a will

Putting it off could mean that your spouse receives less

It's easy to put off making a will. But if you die without one, your assets may be distributed according to the law rather than your wishes. This could mean that your spouse receives less, or that the money goes to family members who may not need it.

There are lots of good financial reasons for making a will:

- you can decide how your assets are shared out - if you don't make a will, the law says who gets what
- if you aren't married or in a civil partnership (whether or not it's a same sex relationship) your partner will not inherit automatically, so you can make sure your partner is provided for
- if you're divorced or if your civil partnership has been dissolved you can decide whether to leave anything to an ex-partner who is living with someone else
- you can make sure you don't pay more Inheritance Tax than necessary

If you and your spouse or civil partner own your home as 'joint tenants', then the surviving spouse or civil partner automatically inherits all of the property. If you are 'tenants in common' you each own a proportion (normally half) of the property and can pass that half on as you want.

A solicitor will be able to help you should you want to change the way you own your property.

Planning to give your home away to your children while you're still alive

You also need to bear in mind, if you are planning to give your home away to your children while you're still alive, that:

- gifts to your children, unlike gifts to your spouse or civil partner, aren't exempt from Inheritance Tax unless you live for seven years after making them

- if you keep living in your home without paying a full market rent (which your children pay tax on) it's not an 'outright gift' but a ' gift with reservation', so it's still treated as part of your estate, and so liable for Inheritance Tax
- following a change of rules on 6 April 2005, you may be liable to pay an Income Tax charge on the 'benefit' you get from having free or low cost use of property you formerly owned (or provided the funds to purchase)
- once you have given your home away, your children own it and it becomes part of their assets. So if they are bankrupted or divorced, your home may have to be sold to pay creditors or to fund part of a divorce settlement
- if your children sell your home, and it is not their main home, they will have to pay Capital Gains Tax on any increase in its value

If you don't have a will there are rules for deciding who inherits your assets, depending on your personal circumstances. The following rules are for deaths on or after 1 July 2009 in England and Wales; the law differs if you die intestate (without a will) in Scotland or Northern Ireland. The rates that applied before that date are shown in brackets.

If you're married or in a civil partnership and there are no children

The husband, wife or civil partner won't automatically get everything, although they will receive:

- personal items, such as household articles and cars, but nothing used for business purposes
- £400,000 (£200,000) free of tax – or the whole estate if it was less than £400,000 (£200,000)
- half of the rest of the estate

The other half of the rest of the estate will be shared by the following:

- surviving parents
- if there are no surviving parents, any brothers and sisters (who shared the same two parents as the deceased) will get a share (or their children if they died while the deceased was still alive)
- if the deceased has none of the above, the husband, wife or registered civil partner will get everything

If you're married or in a civil partnership and there were children

Your husband, wife or civil partner won't automatically get everything, although they will receive:

- personal items, such as household articles and cars, but nothing used for business purposes
- £250,000 (£125,000) free of tax, or the whole of the estate if it was less than £250,000 (£125,000)
- a life interest in half of the rest of the estate (on his or her death this will pass to the children)

The rest of the estate will be shared by the children.

If you are partners but aren't married or in a civil partnership

If you aren't married or registered civil partners, you won't automatically get a share of your partner's estate if they die without making a will.

If they haven't provided for you in some other way, your only option is to make a claim under the Inheritance (Provision for Family and Dependants) Act 1975.

If there is no surviving spouse/civil partner

The estate is distributed as follows:

- to surviving children in equal shares (or to their children if they died while the deceased was still alive)
- if there are no children, to parents (equally, if both alive)
- if there are no surviving parents, to brothers and sisters (who shared the same two parents as the deceased), or to their children if they died while the deceased was still alive
- if there are no brothers or sisters then to half brothers or sisters (or to their children if they died while the deceased was still alive)
- if none of the above then to grandparents (equally if more than one)
- if there are no grandparents to aunts and uncles (or their children if they died while the deceased was still alive)
- if none of the above, then to half uncles or aunts (or their children if they died while the deceased was still alive)
- to the Crown if there are none of the above

It'll take longer to sort out your affairs if you don't have a will. This could mean extra distress for your relatives and dependants until they can draw money from your estate.

If you feel that you have not received reasonable financial provision from the estate, you may be able to make a claim under the Inheritance (Provision for Family and Dependants) Act 1975, applicable in England and Wales. To make a claim you must have a particular type of relationship with the deceased, such as child, spouse, civil partner, dependant or cohabitee.

Bear in mind that if you were living with the deceased as a partner but weren't married or in a civil partnership, you'll need to show that you've been 'maintained either wholly or partly by the deceased'. This can be difficult to prove if you've both contributed to your life together. You need to make a claim within six months of the date of the Grant of Letters of Administration.

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Alternative Investment Market shares

Reducing an Inheritance Tax liability on an estate

Investing in Alternative Investment Market (AIM) shares is one way of reducing an Inheritance Tax liability on an estate. Qualifying AIM shares offer more Inheritance Tax relief than some other assets and qualify as 'business property investments'. If property is held as AIM shares in certain trading companies, for a period of at least two years, it becomes eligible for Inheritance Tax Business Property Relief at 100 per cent and will fall out of the estate for Inheritance Tax purposes. This relief is a relief by value – the shares are treated as having no value for Inheritance Tax purposes.

Not all AIM companies are eligible for Business Property Relief however. To qualify, a company must be a trading company carrying out the majority of its business in the UK. Businesses trading in land or securities, or receiving a substantial amount of income from letting property or land, are excluded. Also, it must not be listed on another recognised stock exchange. If a company qualified for Inheritance Tax relief when the shares were bought, but was subsequently disqualified under these criteria, investors must reinvest their holdings into new qualifying shares within six months to retain the Business Property Relief exemption.

Investing in the AIM will suit financially secure people with other liquid capital who can invest widely enough to bear the risks involved.

Investing in the AIM will suit financially secure people with other liquid capital who can invest widely enough to bear the risks involved. AIM shares can be unpredictable and invest in smaller, less established companies with fewer investors than other stock markets, so share prices can be volatile, rising or falling rapidly. You should always receive professional advice before considering this option to mitigate a potential Inheritance Tax liability.

Minimising an Inheritance Tax liability

Passing assets to beneficiaries using a trust

You may decide to use a trust to pass assets to beneficiaries, particularly those who aren't immediately able to look after their own affairs. If you do use a trust to give something away, this removes it from your estate provided you don't use it or get any benefit from it. But bear in mind that gifts into trust may be liable to Inheritance Tax.

Trusts offer a means of holding and managing money or property for people who may not be ready or able to manage it for themselves. Used in conjunction with a will, they can also help ensure that your assets are passed on in accordance with your wishes after you die. Here we take a look at the main types of UK family trust.

When writing a will, there are several kinds of trust that can be used to help minimise an Inheritance Tax liability. On 22 March 2006 the government changed some of the rules regarding trusts and introduced some transitional rules for trusts set up before this date.

A trust might be created in various circumstances, for example:

- when someone is too young to handle their affairs
- when someone can't handle their affairs because they're incapacitated
- to pass on money or property while you're still alive
- under the terms of a will
- when someone dies without leaving a will (England and Wales only)

What is a trust?

A trust is an obligation binding a person called a trustee to deal with property in a particular way for the benefit of one or more 'beneficiaries'.

Settlor

The settlor creates the trust and puts property into it at the start, often adding more later. The settlor says in the trust deed how the trust's property and income should be used.

Trustee

Trustees are the 'legal owners' of the trust property and must deal with it in the way set out in the trust deed. They also administer the trust. There can be one or more trustees.

Beneficiary

This is anyone who benefits from the property held in the trust. The trust deed may name the beneficiaries individually or define a class of beneficiary, such as the settlor's family.

Trust property

This is the property (or 'capital') that is put into the trust by the settlor. It can be anything, including:

- land or buildings
- investments
- money
- antiques or other valuable property

The main types of private UK trust

Bare trust

In a bare trust the property is held in the trustee's name but the beneficiary can take actual possession of both the income and trust property whenever they want. The beneficiaries are named and cannot be changed.

You can gift assets to a child via a bare trust while you are alive, which will be treated as a Potentially Exempt Transfer (PET) until the child reaches age 18, (the age of majority in England and Wales), when the child can legally demand his or her share of the trust fund from the trustees.

All income arising within a bare trust in excess of £100 per annum will be treated as belonging to the parents (assuming that the gift was made by the parents). But providing the settlor survives seven years from the date of placing the assets in the trust, the assets can pass Inheritance Tax free to a child at age 18.

Life interest or interest in possession trust

In an interest in possession trust the beneficiary has a legal right to all the trust's income (after tax and expenses), but not to the property of the trust.

These trusts are typically used to leave income arising from a trust to a second surviving spouse for the rest of their life. On their death, the trust property reverts to other beneficiaries, (known

as the remaindermen), who are often the children from the first marriage.

You can, for example, set up an interest in possession trust in your will. You might then leave the income from the trust property to your spouse for life and the trust property itself to your children when your spouse dies.

With a life interest trust, the trustees often have a 'power of appointment', which means they can appoint capital to the beneficiaries (who can be from within a widely defined class, such as the settlor's extended family) when they see fit.

Where an interest in possession trust was in existence before 22 March 2006, the underlying capital is treated as belonging to the beneficiary or beneficiaries for Inheritance Tax purposes, for example, it has to be included as part of their estate.

Transfers into interest in possession trusts after 22 March 2006 are taxable as follows:

- 20 per cent tax payable based on the amount gifted into the trust at the outset, which is in excess of the prevailing nil rate band
- Ten years after the trust was created, and on each subsequent ten-year anniversary, a periodic charge, currently 6 per cent, is applied to the portion of the trust assets that is in excess of the prevailing nil rate band.
- The value of the available 'nil rate band' on each ten-year anniversary may be reduced, for instance, by the initial amount of any new gifts put into the trust within seven years of its creation.

There is also an exit charge on any distribution of trust assets between each ten-year anniversary.

Discretionary trust

The trustees of a discretionary trust decide how much income or capital, if any, to pay to each of the beneficiaries but none has an automatic right to either. The trust can have a widely defined class of beneficiaries, typically the settlor's extended family.

Discretionary trusts are a useful way to pass on property while the settlor is still alive and allows the settlor to keep some control over it through the terms of the trust deed.

Discretionary trusts are often used to gift assets to grandchildren, as the flexible nature of these trusts allows the settlor to wait and see how they turn out before making outright gifts.

Discretionary trusts also allow for changes in circumstances, such as divorce, re-marriage and the arrival of children and stepchildren after the establishment of the trust.

When any discretionary trust is wound up, an exit charge is payable of up to 6 per cent of the value of the remaining assets in the trust, subject to the reliefs for business and agricultural property.

Accumulation and maintenance trust

An accumulation and maintenance trust is used to provide money to look after children during the age of minority. Any income that isn't spent is added to the trust property, all of which later passes to the children.

In England and Wales the beneficiaries become entitled to the trust property when they reach the age of 18. At that point the trust turns into an 'interest in possession' trust. The position is different in Scotland, as, once a beneficiary reaches the age of 16, they could require the trustees to hand over the trust property.

Accumulation and maintenance trusts that were already established before 22 March 2006, and where the child is not entitled to access the trust property until an age up to 25, could be liable to an Inheritance Tax charge of up to 4.2 per cent of the value of the trust assets.

It has not been possible to create accumulation and maintenance trusts trust since 22 March 2006 for Inheritance Tax purposes. Instead, they are taxed for Inheritance Tax as discretionary trusts.

Mixed trust

A mixed trust may come about when one beneficiary of an accumulation and maintenance trust reaches 18 and others are still minors. Part of the trust then becomes an interest in possession trust.

Trusts for vulnerable persons

These are special trusts, often discretionary trusts, arranged for a beneficiary who is mentally or physically disabled. They do not suffer from the Inheritance Tax rules applicable to standard discretionary trusts and can be used without affecting entitlement to state benefits; however, strict rules apply.

Tax on income from UK trusts

Trusts are taxed as entities in their own right. The beneficiaries pay tax separately on income they receive from the trust at their usual tax rates, after allowances.

Taxation of property settled on trusts

How a particular type of trust is charged to tax will depend upon the nature of that trust and how it falls within the taxing legislation. For example, a charge to Inheritance Tax may arise when putting property into some trusts, and on other chargeable occasions – for instance, when further property is added to the trust, on distributions of capital from the trust or on the ten-yearly anniversary of the trust.

Trusts are very complicated, and you may have to pay Inheritance Tax and/or Capital Gains Tax when putting property into the trust. If you want to create a trust you should seek professional advice.

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Important exemptions

Legally passing your estate without it being subject to Inheritance Tax

There are some important exemptions that allow you to legally pass your estate on to others, both before and after your death, without it being subject to Inheritance Tax.

Exempt beneficiaries

You can give things away to certain people and organisations without having to pay any Inheritance Tax. These gifts, which are exempt whether you make them during your lifetime or in your will, include gifts to:

- your husband, wife or civil partner, even if you're legally separated (but not if you've divorced or the civil partnership has dissolved), as long as you both have a permanent home in the UK
- UK charities
- some national institutions, including national museums, universities and the National Trust
- UK political parties

But, bear in mind that gifts to your unmarried partner or a partner with whom you've not formed a civil partnership aren't exempt.

Exempt gifts

Some gifts are exempt from Inheritance Tax because of the type of gift or the reason for making it. These include:

- Wedding gifts/civil partnership ceremony gifts

Wedding or civil partnership ceremony gifts (to either of the couple) are exempt from Inheritance Tax up to certain amounts:

- parents can each give £5,000
- grandparents and other relatives can each give £2,500
- anyone else can give £1,000

You have to make the gift on or shortly before the date of the wedding or civil partnership ceremony. If it is called off and you still make the gift, this exemption won't apply.

Small gifts

You can make small gifts, up to the value of £250, to as many people as you like in any one tax year (6 April to the following 5 April) without them being liable for Inheritance Tax.

But you can't give a larger sum – £500, for example – and claim exemption for the first £250. And you can't use this exemption with any other exemption when giving to the same person. In other words, you can't combine a 'small gifts exemption' with a 'wedding/civil partnership ceremony gift exemption' and give one of your children £5,250 when they get married or form a civil partnership.

Annual exemption

You can give away £3,000 in each tax year without paying Inheritance Tax. You can carry forward all or any part of the £3,000 exemption you don't use to the next year but no further. This means you could give away up to £6,000 in any one year if you hadn't used any of your exemption from the year before.

You can't use your 'annual exemption' and your 'small gifts exemption' together to give someone £3,250. But you can use your ' annual exemption' with any other exemption, such as the ' wedding/civil partnership ceremony gift exemption'. So, if one of your children marries or forms a civil partnership you can give them £5,000 under the 'wedding/ civil partnership gift exemption'

and £3,000 under the 'annual exemption', a total of £8,000.

Gifts that are part of your normal expenditure

Any gifts you make out of your after-tax income (but not your capital) are exempt from Inheritance Tax if they're part of your regular expenditure.

This includes:

- monthly or other regular payments to someone, including gifts for Christmas, birthdays or wedding/civil partnership anniversaries
- regular premiums on a life insurance policy (for you or someone else)

It's a good idea to keep a record of your after-tax income and your normal expenditure, including gifts you make regularly. This will show that the gifts are regular and that you have enough income to cover them and your usual day-to-day expenditure without having to draw on your capital.

Maintenance gifts

You can also make Inheritance Tax-free maintenance payments to:

- your husband or wife
- your ex-spouse or former civil partner
- relatives who are dependent on you because of old age or infirmity
- your children (including adopted children and step-children) who are under 18 or in full-time education

Potentially exempt transfers

If you, as an individual, make a gift and it isn't covered by an exemption, it is known as a 'potentially exempt transfer' (PET).

A PET is only free of Inheritance Tax if you live for seven years after you make the gift.

Gifts that count as a PET are gifts that you, as an individual, make to:

- another individual
- a trust for someone who is disabled
- a bereaved minor's trust where, as the beneficiary of an Interest In Possession (IIP) trust (with an immediate entitlement following the death of the person who set up the trust), you decide to give up the right to receive anything from that trust or that right comes to an end for any other reason during your lifetime

Only 'outright gifts' count as PETs

If you make a gift with strings attached (technically known as a 'gift with reservation of benefit'), it will still count as part of your estate, no matter how long you live after making it. For example, if you give your house to your children and carry on living there without paying them a full commercial rent, the value of your house will still be liable for Inheritance Tax.

In some circumstances a gift with strings attached might give rise to an Income Tax charge on the donor based on the value of the benefit they retain. In this case the donor can choose whether to pay the Income Tax or have the gift treated as a gift with reservation.

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A gift with reservation

Making sure the gift is not a gift for Inheritance Tax purposes

A gift with reservation is a gift that is not fully given away. Where gifts with reservation were made on or after 18 March 1986, you can include the assets as part of your estate but there is no seven year limit as there is for outright gifts. A gift may begin as a gift with reservation but some time later the reservation may cease.

In order for a gift to be effective for exemption from Inheritance Tax, the person receiving the gift must get the full benefit of the gift to the total exclusion of the donor. Otherwise, the gift is not a gift for Inheritance Tax purposes.

For example, if you give your house to your child but continue to live there rent free, that would be a gift with reservation. If, after two years, you start to pay a market rent for living in the house, the reservation ceases when you first pay the rent. The gift then becomes an outright gift at that point and the seven year period runs from the date the reservation ceased. Or a gift may start as an outright gift and then become a gift with reservation.

Alternatively, if you give your house to your child and continue to live there but pay full market rent, there is no reservation. If over time you stop paying rent or the rent does not increase, so it is no longer market rent, a reservation will occur at the time the rent stops or ceases to be market rent.

The value of a gift for Inheritance Tax is the amount of the loss to your estate. If you make a cash gift, the loss is the same value as the gift. But this is not the case with all gifts.

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Arranging to pay Inheritance Tax

Who will handle your affairs?

The 'personal representative' (the person nominated to handle the affairs of the deceased person) arranges to pay any Inheritance Tax that is due. You usually nominate the personal representative in your will (you can nominate more than one), in which case they are known as the 'executor'. If you die without leaving a will a court can nominate the personal representative, in which case they are known as the 'administrator'.

If you have been nominated as someone's personal representative you have to value all of the assets that the deceased person owned. This valuation must accurately reflect what the assets would reasonably fetch in the open market at the date of death.

In most cases, Inheritance Tax must be paid within six months from the end of the month in which the death occurs, otherwise interest is charged on the amount owing. Tax on some assets, including land and buildings, can be deferred and paid in instalments over ten years.

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Forms you need to complete

If the estate is unlikely to be subject to Inheritance Tax (an 'excepted estate')	
Country in which the deceased person lived	Required forms for excepted estates
England	Form IHT205 and form PA1 - application for probate
Scotland	Form C1 ('Inventory') and form C5 if they died on or after 6 April 2004; if they died before this date form C1 only
Northern Ireland	Form IH205 only

If the estate is likely to be subject to Inheritance Tax

In this case you complete form IHT400 plus any relevant supplementary forms (these are indicated on the IHT400).

You also complete:

- form IHT421 'Probate summary' if the deceased person lived in England, Wales or Northern Ireland
- probate application form PA1 if the deceased lived in England or Wales
- form C1 Inventory if the deceased lived in Scotland

(In Northern Ireland you only complete a probate application form at interview.)

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Protecting your wealth

Making the most of different solutions

Decreasing term assurance

Decreasing term assurance can be arranged to cover a potential Inheritance Tax liability and used as a Gift Inter Vivos policy. This is a type of decreasing term plan that actually reduces at the same rate as the chargeable Inheritance Tax on an estate as a result of a Potentially Exempt Transfer (PET).

For example, if you gift part of your estate away before death, then that part is classed as a PET, meaning that for a period of seven years there could be tax due on the transfer. This amount of tax reduces by a set amount each year for seven years.

The Gift Inter Vivos plan is designed to follow that reduction to ensure sufficient money is available to meet the bill if the person who gifted the estate dies before the end of the seven-year period.

Such policies should be written in an appropriate trust, so that the proceeds fall outside your estate.

Business and agricultural property

Business and agricultural property are exempt from Inheritance Tax.

Business Property relief: To qualify, the property must be 'relevant business property' and must have been owned by the transferor for the period of two years immediately preceding death. Where death occurred after 10 March 1992, relief is given by reducing the value of the asset by 100 per cent. Prior to 10 March 1992, the relief was 50 per cent.

Agricultural Property relief: Agricultural property is defined as 'agricultural land or pasture and includes woodland and any buildings used in connection with the intensive rearing of livestock or fish if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture; and also includes such cottages, farm buildings and farmhouses, together with the land occupied with them as are of a character appropriate to the property'. Where death occurred after 10 March 1992, relief is given by reducing the value of the property by 100 per cent (certain conditions apply). Prior to that date the relief was 50 per cent.

Woodlands relief

There is a specific relief for transfers of woodland on death. However, this has become less important since the introduction of 100 per cent relief for businesses that qualify as relevant business property.

Where an estate includes woodlands forming part of a business, business relief may be available if the ordinary conditions for that relief are satisfied. When a woodland in the United

Kingdom is transferred on death, the person who would be liable for the tax can elect to have the value of the timber – that is, the trees and underwood (but not the underlying land) – excluded from the deceased's estate.

There is a specific relief for transfers of woodland on death. However, this has become less important since the introduction of 100 per cent relief for businesses that qualify as relevant business property.

If the timber is later disposed of, its value at the time will be subject to Inheritance Tax. Relief is available if:

- an election is made within two years of the death, though the Board of HM Revenue & Customs have discretion to accept late elections, and
- the deceased was the beneficial owner of the woodlands for at least five years immediately before death or became beneficially entitled to it by gift or inheritance.

The Pre-Owned Assets Tax

Pre-Owned Assets Tax (POAT), which came into effect on 6 April 2005, clamped down on arrangements whereby parents gifted property to children or other family members while continuing to live in the property without paying a full market rent.

POAT is charged at up to 40 per cent on the benefit to an individual continuing to live in a property that they have gifted but are not paying a full rent, and where the arrangement is not caught by the Gift with Reservation rules.

So anyone who has effected such a scheme since March 1986 could fall within the POAT net and be liable to an income tax charge of up to 40 per cent of the annual market rental value of the property.

Alternatively, you can elect by 31 January following the end of the tax year in which the benefit first arises that the property remains in your estate.

Rental valuations of the property must be carried out every five years by an independent valuer.

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Inheritance Tax facts

- 1 in 40 people in the UK inherit an average of £17,500 each year. The total after tax is £31bn.
- The average estate leaves £90,000 net of tax and the average amount received by each individual is £17,500. This suggests that, on average, people share out their bequests among five people. Some 10 per cent of beneficiaries receive £50,000 or more. A further 30 per cent receive £10,000 or more, enough to make a down-payment on a home or pay off a sizeable amount of a mortgage.
- The amount raised from Inheritance Tax during the 2006/07 tax year was £3.6bn.
- An estimate for the 2007/08 tax year for the level of revenue raised from Inheritance Tax is expected to be £4.1bn.
- The individual threshold from the current £325,000 (2009/10 tax year) is set to increase by 7 per cent to £350,000 in 2010/11.
- It is possible to pass the unused proportion of a nil-rate band to your spouse or civil partner for use in the future.

Sources: HM Revenue & Customs & International Longevity Centre UK 2008

Inheritance tax nil rate band and rates

Inheritance Tax is charged at the following rate on death:

Inheritance Tax	2009/10 tax year
Taxable value of your estate above which it is charged	£325,000
Rate at which it is charged	40 per cent

Inheritance Tax glossary

Common estate planning terms

Administration
Dealing with the affairs and estate of a person who has died, including collecting their assets, paying their debts and paying the residue to the people who are to benefit.

Affidavit
A document giving evidence which is sworn in front of a solicitor or other person who can administer oaths.

Agricultural Property Relief (APR)
Relief from Inheritance Tax for the agricultural value of some farms and farmhouses (the value if the land and buildings could only be used for agricultural purposes and not the open market value). Various conditions apply, including a minimum ownership period.

Beneficiary
A person or organisation who will receive assets from the estate of the deceased.

Bequests and Legacies
Bequests and legacies are names for gifts left in a will.

Business Property Relief
Relief from Inheritance Tax for businesses; a minimum ownership period applies and the business or interest in the business must fulfil the conditions.

Capital Gains Tax
This is tax which may be payable on a disposal (for example when you sell an asset) if you make a chargeable gain. Usually you have made a gain if the asset is worth more at disposal than it was when you acquired it. A disposal is not only a sale for moneys worth. You will only pay Capital Gains Tax on capital monies (monies that you received) that do not form part of your income. The tax applies not to the value of the asset but to the increase in value.

Caveat
A notice entered at the Probate Registry – for example, if you have entered a caveat you will be warned before any Grant of Representation is issued.

Chattels
Assets of a person other than land – for example, jewellery, ornaments, clothes, cars, animals, furniture and so on.

Charity
A charity is an organisation that has as its aim purposes which are exclusively 'charitable' (as recognised by law), such as the relief of poverty or promoting education. Charities can be structured in a variety of ways – for example, as a company with a board of directors or as a trust fund with a board of trustees. Charities must be for the public benefit. Most charities must register with the Charities Commission. Charities are strictly regulated.

Codicil
An addition to a will which may change, modify, delete, extend or add to a will.

Deed of Variation
A document that can vary the division of a person's estate after they have died, either by changing their will retrospectively or altering the persons entitled on an intestacy (where there is no will or the beneficiaries no longer exist). This must be done within two years of the person's death.

Discretionary Trusts
A trust where the trustees can choose which beneficiaries (if any) should receive income and/ or capital.

Domicile
Your domicile will affect whether you pay Inheritance Tax on particular assets and can affect how much Inheritance Tax you pay. Domicile is not the same as residence.

Estate
All the property and assets of the person who has died.

Executor
This is the personal

representative (see below) who has been appointed by the will or codicil.

Guardian
A guardian will have parental responsibility for any child (under 18) of whom they are named guardian. Parental responsibility means legal authority to act in relation to a child on such matters as medical care, where they are to live, their education and what surname they should be known by. Guardians may be appointed by a parent who has parental responsibility, an existing guardian or the Court. If you name a guardian in your will, the appointment may not take effect if your child has a surviving parent with parental responsibility.

Inheritance Tax
A tax on the value of a person's estate on their death and also on the value of certain gifts made by an individual during their lifetime. You may be subject to Inheritance Tax on all your assets everywhere in the world if you are domiciled in England & Wales. Inheritance Tax also applies to most types of trusts and may be charged when assets are added to or leave the trusts and on the ten-yearly anniversaries of the trust's creation.

Intestate/Intestacy
The rules that govern where a person's estate is to pass and who can deal with the estate in the absence of a will.

Joint Tenancy
A way of co-owning land and other property. On the death of one of the co-owners, the other takes their share by survivorship. For example, if you and your spouse own your home as joint tenants it will automatically pass to the surviving spouse when one of you dies. Your share of your house will not be part of your estate as it passes automatically.

Letters of Administration
A grant of representation where there is no valid will, or there is a will but no executor appointed.

Life Tenant
This is a person who is entitled to benefit from a trust during their lifetime. They cannot have the capital in the trust fund; they are entitled only to the income or enjoyment of the property. For example, if the trust fund was a house, the beneficiary would be entitled to live there.

Personal Representative
The person who is dealing with the administration of the estate of the person who has died.

Potentially Exempt Transfer (PET)
This is an outright gift by an individual to another individual or certain types of trusts. If the giver (donor) survives the gift by seven years it will become completely exempt from Inheritance Tax, and will be outside the donor's estate for the purposes of calculating Inheritance Tax.

Power of Attorney
This is a formal document giving legal authority from one person (the donor) to another (the attorney) so that the Attorney may act on behalf of their principal. Power of Attorney may be an ordinary General Power or it may be a Lasting Power of Attorney.

Lasting Power of Attorney
A Lasting Power of Attorney can relate to your property and affairs or your personal welfare, i.e. decisions about your medical treatment. In order to make a Lasting Power of Attorney you must have mental capacity to do so, which must be certified by a certificate provider. An ordinary General Power of Attorney will come to an end if you lose your mental capacity but a Lasting Power of Attorney will not.

Probate (Grant of)
The 'Proving' of a will by sending it to the Probate Registry.

Residue
The remainder of the estate of the person who has died after all their debts have been paid and any specific gifts they made under their will have also been paid.

Revocation (of will)
This is the process by which someone cancels or takes back a will (or codicil) made previously when they no longer intend that will to take effect. The Testator (person who made a will or codicil) must have mental capacity to revoke the will (or codicil). The effect of revocation is that any earlier will is resurrected and will take effect as if the later cancelled will does not exist. If there is no previous will then the person revoking their will becomes intestate. Most new wills contain an explicit clause stating that they revoke any previous wills. There are formal requirements for revocation of a will as there are for making a will.

Statutory Legacy
If a person dies intestate with a spouse or civil partner, the statutory legacy is the amount of the deceased's estate that their spouse or civil partner will receive. A common misconception is that the spouse or civil partner will automatically receive all of the estate of the person who has died intestate, but this is not necessarily the case if there are surviving children and it is therefore desirable to make a will to ensure that your spouse or civil partner inherits all that you intend them to take.

Testator/Testatrix
The person making a will (male or female).

A Trust
A legal relationship in which one or more persons hold property for the benefit of others (the beneficiaries). A trustee is the person who is acting in the trust and holds the property for the benefit of someone else.

A Will
The formal document known as a 'testamentary disposition' by which somebody confirms their wishes as to the division of their estate on death.

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