SPK Shah & Co Ltd.

Chartered Accountants, Registered Auditors & Chartered Tax Advisers

KEY GUIDE

You and yours – planning your estate

Inheritance tax (IHT) can affect not only wealthy individuals but also UK homeowners with modest savings. It is, however, still possible to ensure that your estate passes to your family with minimal IHT liabilities.

How IHT is calculated

IHT is a tax on an individual's estate on death and on certain gifts made during their lifetime. When an individual dies, IHT is charged at 40% on the value of an individual's estate which exceeds their available nil rate band (£325,000 in the tax year 2012/13). Any gifts made within seven years of death will reduce the nil rate band available on death.

Since 8 October 2007, the estate of a spouse/civil partner is able to benefit from the deceased spouse/civil partner's unused IHT nil rate band, regardless of when the first death occurred.

The amount of the nil rate band available for transfer is based on the proportion of the nil rate band that was unused when the first spouse/civil partner died. The unused proportion will be applied to the amount of the nil rate band in force at the date when the surviving spouse/civil partner dies.

For example, David dies today leaving his children £108,333 (i.e. one-third of the current nil rate band) and the rest of his estate to his wife, Jane. On Jane's subsequent death, her nil rate band will be increased by two-thirds. So, if the nil rate band at the time of Jane's death is £360,000, she will be able to leave £600,000 free of IHT, i.e. £360,000 plus £240,000. The nil rate band of the survivor can be increased by a maximum of 100%.

Focus point

The amount of the nil rate band available for transfer is based on the proportion of the nil rate band that was unused when the first spouse/civil partner died.

Taper relief ensures a reduced rate of IHT is payable if any gifts were made more than three years, but less than seven years, before death. There is also a 20% lifetime rate of IHT payable on gifts made to a discretionary trust whose value plus any other chargeable gifts made in the previous seven years exceeds the nil rate band. For deaths after 5 April 2012, the rate of IHT on the estate will be reduced to 36% if at least 10% of the taxable estate is left to charity.

Potentially exempt transfers

Gifts to individuals or to a bare trust are called potentially exempt transfers (PETs) and will be outside of the estate after seven years. Making lifetime gifts can be an effective way to avoid IHT.

Exemptions

Some gifts are always exempt from IHT.

- Transfers between spouses/civil partners.
- Gifts up to the value of £3,000 a tax year (the exemption can be carried forward for one year).
- Any number of small gifts of up to £250 to each donee in a tax year.
- Regular gifts from income, provided they do not reduce the person's usual standard of living.

- Wedding gifts up to a limit determined by the relationship between the donor and the bride or groom.
- Gifts and bequests to UK charities, political parties and for the public benefit.

Business and farming assets

Interests in businesses and agricultural property may benefit from IHT reliefs, subject to certain conditions.

100% IHT relief is given for:

- Shares in an unlisted trading company, or a trading company listed on the Alternative Investment Market (AIM) or the 'over-the-counter' market PLUS.
- The business of a sole trader or an interest in a partnership.
- Owner-occupied farms and tenanted farms where the lease started after 31 August 1995.

50% IHT relief is given for:

- Assets owned by an individual and used by a trading company under their control, or by a partnership in which the individual is a partner.
- Tenanted farmland where the lease started before 1 September 1995.

Gifts with reservation

If you make a gift from your estate and still retain an interest or benefit in it, it is called a 'gift with reservation' and it makes the gift ineffective from an IHT perspective.

Focus point

The earlier IHT planning starts, the more effective it is likely to be. It is important that you leave yourself with adequate income/capital, before making any major lifetime gifts.

Pre-owned assets tax

A gift that does not fall within the gifts with reservation rules may give rise to a special annual income tax charge if you continue to enjoy a benefit from a previously owned asset.

Trusts

Trusts allow you to transfer money and assets to the legal ownership of trustees who will look after the trust property. Trusts are often created if there are child beneficiaries or beneficiaries who are incapable of looking after their own affairs.

IHT planning

The earlier IHT planning starts, the more effective it is likely to be. It is important that you leave yourself with adequate income/capital, before making any major lifetime gifts. Some other issues to consider are:

- Making an up-to-date, tax-efficient will.
- Giving away assets that you will not need.
- Making use of annual exemptions.
- Using your deceased spouse's/civil partner's nil rate band, if available.
- Paying into a pension plan. Having a comfortable retirement means that you may be able to give away some investments, and pension death benefits are also

generally IHT-free.

- Equity release can reduce IHT and boost income in retirement.
- Consider establishing a lump- sum IHT plan that allows you to make a gift into a trust, while still retaining an income.
- Capital gains tax may be payable if you gift an asset that has a gain.

How we can help

We can help you draw up an IHT plan to protect your family's wealth by ensuring you have reviewed your assets, income and needs – both now and in the future.

Make a will

If you do not have a will, the laws of intestacy will dictate who will benefit from your estate.

- Your common law partner may be left with nothing.
- A will can appoint a guardian for your children to ensure their future needs are considered.
- You may have overseas assets and need a will in each relevant jurisdiction.
- A will can also help with tax planning.

Keep your will up to date

Remember to keep your will up to date, since marriage can invalidate a will. Ensure you take the appropriate legal advice.

How we can help

It is important that your will and any other estate planning reflect the realities of your tax and financial position. We can work with your legal advisers on the best way to structure your will, or introduce you to specialist advisers. We can also construct an effective tax and investment planning strategy to benefit your family and to cover any business interests you may have.

Focus point

If you do not have a will, the laws of intestacy will dictate who will benefit from your estate. Your common law partner may be left with nothing.

IHT strategies

There are many different IHT planning strategies, some of which are outlined below.

Strategy one – start a programme of lifetime gifts

The main way to reduce IHT is to make lifetime gifts. Many arrangements will still leave you with access to capital or income if required.

Discounted gift trusts allow you to make an IHT-effective gift into a trust, while still receiving an income. The value of the gift may be significantly less than the amount invested, depending on your age, sex and state of health.

Loan trusts are suitable if you require access to your capital. You make a loan to trustees that is interest-free and repayable on demand. The trustees invest this in a life assurance bond and any investment growth is held for your beneficiaries. Any outstanding loan repayments on your death will form part of your estate for IHT purposes.

Back-to-back arrangements involve buying an annuity (which converts capital into income) and then using some (or all) of the annuity payments to fund a whole of life assurance policy held in trust. The annuity takes the cash out of your estate straight away and can provide a lifetime income, and the life assurance policy provides tax-free benefits on death.

Strategy 2 – Make use of tax-relieved investments

You can buy assets that qualify for business or agricultural relief without becoming closely involved in managing a business/farm by investing in AIM shares, which include qualifying trading companies. AIM and other unquoted companies are likely to be riskier investments than quoted companies.

Strategy 3 – Use life assurance policies to fund the tax

Using a life assurance policy to fund the expected IHT bill allows the policy proceeds to be used to pay the tax. Such a policy should be structured so that the proceeds will be paid out after both spouses or civil partners have died, since this is the time when the major tax liability will arise. It is also essential that the policy should be placed in trust – otherwise, the policy proceeds will form part of the taxable estate of the surviving spouse or civil partner and will suffer a tax charge.

The policy premiums are usually treated as exempt transfers, falling within your annual exemptions or perhaps qualifying as part of your normal expenditure from income.

Focus point

IHT planning involves making important and personal decisions about your family wealth. It is important to obtain competent qualified advice and to keep this under regular review.

How we can help

IHT planning involves making important and personal decisions about your family wealth. It is important to obtain competent qualified advice and to keep this under regular review. Contact us to review your IHT planning or any other aspect of your financial position.

Trusts

Trusts can be set up for all kinds of reasons.

Who is involved in a trust?

The settlor is the person who sets up the trust, which is normally established by a trust deed.

The trustees hold the trust property for the beneficiaries, to whom they owe a duty of care.

The beneficiaries may be entitled to all or just some aspect of the trust fund, i.e. the income or capital from the trust. Their entitlement may be absolute or the trustees may have some discretion as to how and when assets may be distributed to the beneficiaries.

Main types of trust

There are several different types of trust:

A bare trust is one where generally, the beneficiary is a minor and cannot legally hold the property until they are aged 18.

An interest in possession trust is where one or more beneficiaries have a right to the trust's income.

A discretionary trust is where the trustees have discretion over the distribution of the trust's income and/or capital.

An accumulation and maintenance trust is a special discretionary trust for young people. It has not been possible to set up new accumulation and maintenance trusts since 22 March 2006, though there are some still in operation. The beneficiaries become entitled to the property, or at least the income from it, when they reach a certain age (no older than 25, although there are IHT implications if older than 18).

The taxation of trusts

There are special rules for taxing settlors, trustees and beneficiaries, which vary according to the different types of trust and the residence of the parties concerned.

Inheritance tax

The rules for the IHT treatment of interest in possession and accumulation and maintenance trusts were generally aligned with those for discretionary trusts on 22 March 2006.

Focus point

Clearly, ongoing tax and financial planning will be needed to ensure the trust continues to meet your needs and complies with changing tax legislation.

Broadly speaking, the property held in the trust, in excess of the nil rate band, is subject to a periodic charge of up to 6% every ten years and there could be a further charge when capital is distributed to the beneficiaries.

If beneficiaries have an interest in possession created before 22 March 2006 or, in some instances, on the settlor's death, there could be an IHT charge if the beneficiaries either die or give away their interest.

How we can help

- We can work with your lawyers to ensure that you set up a trust that most meets your needs and wants.
- We can advise on the tax implications involved in the transfer of property to the trust.
- We can provide a wide range of services from record-keeping and tax compliance to liaison with investment and other advisers. Clearly, ongoing tax and financial planning will be needed to ensure the trust continues to meet your needs and complies with changing tax legislation.

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SPK Shah & Co Ltd
B: 216 Melton Road Leicester LE4 7PG
T: 0116 261 0450   F: 0116 266 2196
W: www.spkshah.co.uk E: info@spkshah.co.uk

Directors
S.K. Shah BSc (Econ), ACA, CTA   P.K. Shah BA, ACA, CTA