A Guide to Ideas for Inheritance Tax Planning

Mishcon de Reya

Inheritance tax (IHT) is payable at 40% on the value of your estate on death. However, it is sometimes described as a "voluntary tax". That's because with careful planning during your lifetime, you can legally minimise or even totally avoid tax on your death. This guide describes some of the tax-saving options to you. Alternatively you may be more concerned about the future tax liability on your parents' death. Many of the ideas in this guide are equally applicable to them.

LIFETIME INHERITANCE TAX PLANNING – OUTRIGHT GIFTS

Gifts of any size

You can make outright gifts of any size to anyone and these will generally be exempt from inheritance tax, provided you survive the gift by seven years or more. However, you may be concerned that the gift will be frittered away by the recipient or will be lost on the possible divorce or bankruptcy of the recipient. In that case a trust may be more appropriate.

Regular gifts out of income

Regular gifts are exempt from inheritance tax if made as part of your normal expenditure out of income. You must be able to show that after each gift, you still have sufficient net income to maintain your usual standard of living. The big advantage is that there is no need to survive seven years from the date of each gift for it to be exempt from inheritance tax.

Trusts for cash or property

Despite recent criticism, trusts continue to play a useful part in lifetime IHT planning and could save your beneficiaries tens or even hundreds of thousands of pounds of tax. You can transfer cash or other assets up to the value of the IHT nil rate band (currently, £325,000) into a trust for future generations every seven years without an immediate IHT charge (anything above this limit would be taxed at 20% on transfer).

If a husband and wife in their 60s each transfer the nil rate band amount into a trust every seven years, then after just 21 years they will have taken almost £2 million out of their taxable estate, potentially saving almost £800,000 of tax for their beneficiaries. If either the nil rate band or the value of the trust assets increases, the overall tax saving could be far more than this.

Trusts not only preserve flexibility over who gets what, and when, but they are simple to run. You can be a trustee of the trust and the class of beneficiaries can be extremely wide. It would usually include children and grandchildren and perhaps other family members and charities, although generally it should not include you or your spouse or civil partner.

The trust assets will be outside your own taxable estate (provided you survive seven years from the transfer), thereby avoiding the 40% IHT charge on death. Equally importantly, the trust assets will remain outside the taxable estate of any of your beneficiaries, with only a small tax charge within the trust itself. You can therefore create a long-term flexible vehicle to hold family wealth with little or no IHT liability for anyone.

Trusts for business assets

If you own a business or shares in a private trading company, the shares may qualify for 100% IHT business property relief (BPR), meaning that they are totally exempt from IHT. In that case, you could transfer some or all of your business or shares into a discretionary trust irrespective of their value. There would be no upper limit on how much can be transferred without the initial 20% IHT charge, which usually applies on lifetime transfers into trusts.

Capital gains tax considerations

Capital gains tax (CGT) is usually payable when you give assets away if they are worth more today than when you originally acquired them. This applies whether you give the assets away directly to family members or you transfer them into trust (although CGT hold over relief may be available on gifts to certain trusts). This is often a big disincentive to IHT planning. In some cases, asset values may have reduced in recent years and therefore there may be little or no gain anyway. In those circumstances it would be ideal to transfer those assets into a trust to achieve significant IHT savings without triggering an accompanying CGT charge.

Family partnerships

If you would like to give valuable assets to a lifetime trust, but you are deterred by the initial 20% IHT charge that applies to transfers above the nil rate band, one alternative may be a family partnership. This is a flexible structure that has many of the same features as a trust, but avoids the initial 20% tax charge that applies to large transfers to trusts.

Non-domiciled individuals

If you are non-UK domiciled, you may have an opportunity to transfer unlimited overseas assets into a trust without any IHT charges now or in the future. Depending on your residence status and other factors, there may also be no CGT to pay on the transfer into trust.

Any non-UK trust assets would continue to escape IHT even if you become UK domiciled in the future.

Business property relief

If you own a business or shares in a private trading company, the business or the shares may qualify for 100% business property relief (BPR), meaning that they are totally exempt from IHT. Shares in most companies quoted on AIM qualify for BPR.

It may be worth deliberately investing in qualifying assets and holding them until death simply to benefit from the IHT exemption. The risk is that you could lose more money on the investments than you will save in IHT, particularly as such investments are generally high-risk by their nature. However, there are some investment products that are specifically designed to be low-risk and yet still qualify for BPR.

If you have children who own their own business, there may be an opportunity for you to invest cash into that business. This passes cash down a generation and leaves you with shares that qualify for 100% BPR on your death. You can then leave those shares tax-free to your children under your Will. Alternatively if you own a business, your parents may have spare cash to buy your shares and they could then leave you the shares tax-free under their Wills.

Planning with the family home

It is now very difficult to reduce IHT payable on the family home if you still want to live in it. However we have devised a strategy that can achieve significant IHT savings while allowing you to continue living in the family home rent-free. It is particularly suitable if some or all of your children or grandchildren are reasonably wealthy in their own right. Alternatively it may be suitable for your parents' home.

If you are married or in a civil partnership, we also recommend structuring your Wills in a particular way that can achieve an IHT reduction for the family home on the survivor's death.

It should be noted from 2017 there is a new residence nil rate band of £100,000 when residential property is passed to direct descendants. Please seek advice before carrying out any planning with your home.

Gifts to charity

If you leave money to charity, whether during your lifetime or in your Will, the gift will be exempt from IHT. There is further incentive to leave a charitable legacy in your Will. A legacy to charity of at least 10% of your taxable estate will result in a reduction in the rate of IHT payable on the rest of your estate from 40% to 36%.

Tax-efficient Wills

If lifetime tax planning does not appeal to you, you can still achieve significant IHT savings for your beneficiaries by having a tax-efficient Will. In particular, if you were a widow or widower who has since remarried, you may be able to take advantage of a "double nil rate band" which could otherwise inadvertently be lost if your Will is not properly worded.

Similarly you could be caught by many other tax traps if you do not have a well-drafted Will, particularly if you are married and you own business assets, or if your estate might potentially pass to young children or grandchildren.

Finally, if you are married or in a civil partnership, we can prepare your Wills in a particular way which can reduce the tax payable on the family home on the survivor's death.

WHAT TO DO NEXT

If you want to ensure that, as far as possible, your assets go to your beneficiaries rather than HMRC, we can undertake a full review of your particular situation.

For further information, or to make an appointment, please contact:

Andrew Goldstone
Partner, Head of Tax
T +44 20 3321 7205
E andrew.goldstone@mishcon.com
Twitter @GoldstoneTweets

Disclaimer:
This is a very basic summary of a complex area of law and taxation. It is not to be taken as legal advice. Before acting or omitting to act in relation to your UK tax position, you should always take specialist tax advice.

Africa House
70 Kingsway
London
WC2B 6AH

T +44 20 3321 7000
F +44 20 7404 5982
E Contactus@mishcon.com

www.mishcon.com

Mishcon de Reya