

Inheritance Tax: Protecting your beneficiaries' interests

What is Inheritance Tax?

Inheritance Tax (IHT) is a tax charged on the property and assets held by an individual at the time of death, payable by the executors. IHT can also arise in connection with certain gifts made during life.

Most people assume that their heirs will automatically receive the full value of any estate that is left to them, but unfortunately this may not be the case. Inheritance Tax is no longer a problem only for the rich. Each year the government announce the IHT threshold (otherwise known as the Nil Rate Band), and estates valued at more than this threshold are potentially liable for IHT.

Transferability of a nil rate band

This applies to married couples and civil partnerships only.

- If any part of the nil rate band is not used on the first death, then the unused proportion can be preserved and transferred to the surviving spouse/civil partner for use on their death
- The maximum that can be claimed is double the nil rate band in force in the year of the second death. For 2009/10 the maximum will be £650,000
- The change applies to existing widows and widowers, who will now need to ascertain what level of nil rate band was utilised originally. However, where the person has survived more than one spouse/civil partner the additional nil rate band is restricted to the value in force at the time of the second death.

This will generally mean that nil rate band discretionary trusts are no longer required to ensure that the nil rate band is not wasted on the first death, but may still be valid for co-habiting couples that are not married or in a civil partnership, and for other tax planning purposes. Existing wills should be reviewed and may need changing.

Calculating the value of your estate

The IHT payable on death is based on the total net worth of your estate, which takes into account what you own, what you owe and lifetime gifts made. If the net value of your estate is less than the total threshold(s) available then there will be no IHT liability. Anything over this amount may become subject to tax charged at a flat rate of 40%, therefore leaving your heirs with a potentially large tax bill to pay on their inheritance.

Protecting your wealth for the next generation

Fortunately, with a little thought and planning, there are steps you can take to reduce the impact of this tax liability for your heirs:

- Make a tax efficient Will and update it to reflect any changes in your circumstances
- Take advantage of the special reliefs and exemptions available
- Consider lifetime giving
- Take out insurance to provide the means to pay the tax

In planning to protect your heir's future, you must remember not to neglect your own and ensure that you retain enough of your wealth to maintain your lifestyle and cover any unexpected financial emergencies.

Special reliefs and exemption rules

Some reliefs and exemptions are available in certain circumstances to reduce the impact of Inheritance Tax. Exemptions include:

- Unlimited transfers between spouses / civil partners who are both domiciled in the UK
- 'Potentially Exempt Transfers' (PETs) - Lifetime gifts made to individuals or certain trusts that have been made more than 7 years prior to your death and from which you have retained no benefit
- Gifts made to UK based charities
- Gifts in contemplation of marriage / civil partnerships (within set limits)
- Gifts not exceeding £3000 in any tax year
- Small gifts up to a value of £250 per person in any tax year

There are two principal reliefs from IHT:

- *Business property relief*: Available for transfers of certain categories of business and business assets, provided they qualify as 'relevant business property' and have been owned for a minimum period
- *Agricultural property relief*: Available if the transfer is attributable to the agricultural value of the property, provided the property has been owned, and occupied for agricultural use, for a minimum period.

Reliefs seek to reduce the chargeable value of qualifying assets and bring many business interests and farms out of the IHT bracket. In certain circumstances, you can get up to 100% relief, but seek professional advice to find out exactly what you are entitled to.


Why do you need IHT planning?

If you don't want your family to pay large amounts of tax unnecessarily, and want them, rather than H M Revenue & Customs, to benefit fully from their inheritance, then planning is essential and the earlier the better.

With constant changes to the Nil Rate Band and other various rates, IHT becomes a very complex area. Seeking professional advice will ensure that you are fully aware of all the current rates and what is applicable to you, and will help ensure that, as far as possible, you avoid the IHT net.

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