Property Secrets

Inheritance Tax Secrets

How to hang on to your wealth – even after death!

By Colin Davison

Part of the Property Secrets Series

www.propertysecrets.net

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As authors we have endeavoured to deliver information and advice of the highest quality, however you are advised not to rely on this book as your sole source of advice.

The basic principles in this book are founded on substantial experience and backed up by statistical evidence. However, please take care - not every property behaves as the 'average' - there are always lots of risky options around and we encourage you to take full and good advice on any investments or purchases that you intend to make. Equally, the nature of markets is that they are unpredictable.

Don't forget the story of the statistician who drowned in a river that was (on average) only 1 metre deep!

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Contents

1 INHERITANCE TAX CAN SERIOUSLY DAMAGE YOUR WEALTH!

Welcome. This is your guide to legitimately keeping as much of your hard earned cash and assets away from the clutches of the tax man after your death.

It's a startling fact that, even after a lifetime of paying taxes on everything you've earned, you can end up being taxed all over again – just for dying!

Inheritance Tax Secrets follows on from the incredible success we enjoyed with Property Tax Secrets. We're very proud to have saved thousands of readers many thousands of pounds with our advice!

Now it's the turn of inheritance tax. Having experienced the complications, misunderstandings and poor advice that surround this subject, I realised that some sound advice in language that makes it available to everyone was long overdue.

It's something that most of us don't like talking about; what happens to our finances after we die. But we all know that the time comes to make sensible decisions about our money and our belongings.

I talked to our resident tax advisor, Colin Davison, who so expertly delivered our last tax bible. He was also astonished at the poor information to be found on the market.

So, we set Colin to work to produce a book that tells us all we need to know about inheritance tax and what we can do to minimise it, all in a way that exploits the extensive resources of Colin's firm, Cranleys, but in a jargon-free style that we can all understand.

So what does this book do for you?

Well, we hope it:

- Helps you reduce your inheritance tax liability and so gives your family more money
- Helps you plan for your, and your family's, future
- Explains all inheritance tax matters in a down-to-earth way so that you can make some good decisions about your home, your savings, your business and your Will.

In a nutshell, we hope we can help save you money. Enjoy.

Neil

www.PropertySecrets.net

1.1 About the author

Colin Davison ACA BSc CertBA DipBA

Having completed his degree in Regional Science at Reading, Colin immediately embarked on his life ambition – to be a Chartered Accountant!

Initially, he worked at a small firm in Horsham, and later at Grant Thornton.

After completing training, and then qualifying as a Chartered Accountant while at Grant Thornton, Colin undertook assignments to help change and build Blue Chip corporations – including IBM, Microsoft, Siemens and Allied Pickfords.

During 1999, he worked as an advisor for small businesses. During this time, Colin also contributed to a Q&A section in the Mail on Sunday.

After providing support as a Financial and Tax Advisor within ambitious small businesses during the dot-com era, Colin formed Cranleys in 2001 to support the vast number of people moving into self-employment.

Today, Cranleys has a mixture of clients keen to establish good control of their tax and accounting affairs. The company principally focuses on property investors, consultants and those looking to develop their businesses and who seek the pro-active support Cranleys provides.

In 2004, Colin met Neil Lewis of Property Secrets and edited the Property Tax Secrets book. Inheritance Tax Secrets is the second of a series of tax guides.

The Cranleys team - providers of tax advice and research – were invaluable in compiling this book. I hope you enjoy the result and, most of all, find it useful.

Cranleys offer pro-active support to assist you in deciding on your IHT strategy.

Contact me, Colin Davison at colin@cranleys.co.uk

Our website is at www.cranleys.co.uk

1.2 Bonus item: IHT Calculator

As part of your purchase of Inheritance Tax Secrets, you also receive a specially designed inheritance tax calculator.

This fantastic tool lets you enter the balance of your lifetime transfers against your current wealth status.

You can enter data against a number of asset types, giving you the total value of your estate.

As you watch the inheritance tax calculator add up your wealth, you can instantly make decisions about your inheritance tax position.

Excellent value for you and your future!

1.2.1 Opening the Inheritance Tax Calculator

Opening your spreadsheet software:

There are different spreadsheets depending on your computer software.

Essentially,

If your PC runs **Microsoft Excel** then

Click here to open the **Inheritance Tax Calculator**

If your PC runs **Microsoft Works** then

Click here to open the **Inheritance Tax Calculator**

If you have problems opening or using the spreadsheets or any other parts of your Property Secrets e-book, there is a comprehensive help section online at the following address:

www.propertysecrets.net/faq.html

1.2.2 Opening the Spreadsheets on an Apple Mac

According to Apple's website www.apple.com/appleworks/ the latest version of Appleworks software should be able to read Microsoft Excel spreadsheets.

If you have Appleworks 6.04 then there is a small file to download to upgrade it to accept Excel files at:

www.apple.com/appleworks/update/ instructions are on the web page.

If you have an earlier version of Appleworks (6.0 or 6.03) then please go to: www.info.apple.com/usen/appleworks to upgrade to Appleworks 6.04, then use the above link (www.apple.com/appleworks/update/) to upgrade to Appleworks 6.1 first.

It seems a little complex - but all the info is on Apple's support page for Appleworks. At the time of writing, the upgrades are free.

1.3 Ten Top IHT tips

In a hurry or need quick advice? Then go straight to Appendix 2 - Ten Top IHT money saving tips where you'll find the ten best IHT planning tips. These tips are guaranteed to help save you money and plan better for your future.

Of course, they are far easier to understand and benefit from once you've read the rest of this book!

2 Where there's a Will…there's inheritance tax

Death and taxes. All that anyone can be certain of, said Henry Ford. What he should perhaps have mentioned was that the latter doesn't end after the former…you can still be hammered for tax even after you've died!

That's because when you die everything you owned will be liable to an inheritance tax (IHT). It might even surprise you that during your lifetime, you might have to pay IHT when giving – or receiving – money, possessions, property and business interests.

2.1 What is inheritance tax?

At its simplest, inheritance tax is a tax due on your belongings following your death.

What IHT definitely is not is a tax just for a few very rich people.

More of us than ever before are liable to give up almost half (40%) of our estate to the taxman. Ok, so *you* won't actually pay IHT when you die. But your nearest – and presumably dearest – will have to pay it. And they won't thank you very much for feckless financial planning.

This is a book about IHT, but it's also about planning life, after your death. This book doesn't contain miracles, but it will save you time, and it will make it easier for those who survive you to benefit from your estate.

2.2 IHT affects YOU!

IHT affects everyone, directly or indirectly. Knowing your IHT rights, and planning against wrongs, simply makes good sense and will save you money.

There is little that is more undignified than families rowing over who has the rights to your record collection, sports car and savings account!

This is just one reason why you need to start understanding IHT now.

Soon you'll be able to make more of an inheritance, whether you're passing it onto relatives, or receiving it from them.

This book will help you make decisions about IHT questions you may face:

- Do you just give your house to your kids, or use a Trust? If so, what kind of Trust?
- How much can you give to your children in your lifetime without paying tax?
- Can you give your kids an income without paying IHT?
- How much do you have to pay to pass your business on?

- How do insurance policies help you plan against IHT?
- Can you avoid IHT altogether?

My aim is to tackle all these questions and many others, without getting too involved in the kind of detail that will be handled by your accountant or solicitor.

There are plenty of examples, and full case-studies should help everything sink in.

This book isn't a guide to other taxes, namely income tax and capital gains tax. You may be liable to these taxes when making lifetime gifts. We will make a passing mention of these taxes where relevant, but no more.

Before you can begin planning your estate, or helping someone else with theirs, you need to know the IHT fundamentals. Once you've read this section you'll understand:

- Where inheritance tax came from
- What inheritance tax is
- Where inheritance tax applies

2.3 The history of IHT – in three paragraphs

In the UK, death taxes have been turning folk in their graves in some form or other since 1796.

Modern inheritance tax was introduced in 1986, and it replaced the old capital transfer tax. The 1986 version of IHT included some new twists on the old tax, the most important being the removal of liability for tax on certain transfers of funds between one person and another.

At a formidable basic rate of 40%, it's no surprise that IHT is big business for the Government. In fact, it pulls in almost £3 billion a year.

One of the reasons that figure is so high is undoubtedly because there is so little decent IHT advice around. Perhaps this is a new definition of a stealth tax!

Thousands of us are still making poor decisions when planning our estates.

The IHT allowances are revised every April, and this book covers the changes in effect from April 1st 2005 and changes in 2006.

2.4 How am I liable for Inheritance Tax?

IHT is paid on any estate that is passed on to someone else. Since we don't all own a 25-bedroomed mansion, surrounded by 10 acres of lush countryside and a gaggle of swans, you may be mistaken for thinking you didn't own an 'estate'.

Mr Taxman defines your estate as anything you own – be it property, business, car, money or investments; it also includes any shares you may have in any of these. Your estate extends to any property or business you are receiving an income from – you don't even have to own it!

So your estate is literally all of your material worth. Swans and all.

If it's not nailed down, you'll pay tax on it (actually regardless of whether it's nailed, super-glued or cemented you'll pay tax on it). That, at least, is the theory.

In terms of value, the bits that make up your estate – car, house, possessions, etc, are calculated at market value. Not what you decide they're worth!

2.5 Exceptions to the rules

There are a whole host of exceptions, rules and counter rules. Tax is rarely straightforward. Some rules are simple, though. For example, if you transfer your estate to a spouse – whether in life or death – it won't be hit by IHT.

Example 1

Having passed away, Colin Davison leaves his entire estate, valued at £500,000, to his wife. She is not liable for any IHT.

Notice that in this example, the estate was passed to Mr Davison's **wife**, used here as a legal term, i.e., a legally recognised spouse.

Common-law partners do not enjoy IHT exemptions. Had the estate in the above example been passed to Mr Davison's common-law partner, she would be liable to pay the full IHT rate.

It's a different story for spouses not domiciled (i.e. who do not have their permanent home) in the UK. Non-UK domiciles do not pay IHT on the first £55,000 of the estate. The rest of the estate will be taxed at the normal rate.

Any one else – friends or family - will pay IHT, subject to the relevant tax bands and exemptions, which we'll soon discuss. There are no discounts for sons or daughters. The only other exemption from IHT is the estates of those members of the armed forces who are killed or who die while on active military service.

2.6 Summary

After reading this section you should know what IHT is and how it may affect you. You should also know that:

- IHT is charged on your estate. Your estate is EVERYTHING you own, calculated at current market value.
- Spouses are exempt from IHT (but IHT planning goes beyond your generation!)
- Non-UK domiciled spouses are only IHT exempt for the first £55,000 of an estate.

3 How does IHT work?

Inheritance tax works within a number of strict, often complicated rules and regulations. But don't worry, we're going to break it all down so it makes perfect sense.

In this section, you'll learn about what portion of your estate is liable for IHT. And you'll also find out about the tax due on gifts made by you in your lifetime.

3.1 The IHT allowance threshold

Thankfully, not all of your estate will fall victim to IHT. The Government has sought to protect us everyday folk, by granting a seemingly large tax exemption band.

The current threshold for IHT is £285,000 – known as the Nil Rate Band (NRB).

If you inherit, or pass on, an estate up to this value then it will not be taxed. The NRB is increased a little every year by the Government. Understandably, the NRB comes under increasing criticism for being pitched too low.

3.2 Why more of us are paying IHT?

The answer to this one is simple – it's because of the increased value of people's homes. The increase in the value of property has propelled many beyond the £285,000 Nil Rate Band safety net. Nowhere has this been more noticeable than in London and the South East.

In fact, 41% of annual IHT contributions in the UK now come from people's own homes.

Besides property, most of the rest of IHT contributions come from cash savings (26%), shares and securities (12%) and household personal effects, insurance and other land holdings (21%).

Example 2a – Basic IHT rate

Cieran dies having left his entire estate to his daughter, Jane. The estate is valued at £400,000. This estate comprises a house (£325,000), savings (£55,000), a car (£12,000) and a collection of paintings (£8,000).

Jane is exempt from paying tax on the first £285,000. But she will pay 40% on the remainder: £400,000 - £285,000 = £115,000.

So the IHT on this amount will be as follows:
£115,000 x 40% = £46,000 tax.

So, after IHT, Jane will be left with £400,000 - £46,000 = £354,000

Let's understand how the basic 40% IHT rate works:

Example 2b – More basic IHT rates

Craig dies leaving half of his £2million estate to his wife. The rest will be shared equally between his two daughters.

His wife's £1million is not subject to IHT as married couples are exempt from IHT.

The remaining £1million will be taxed. The first £285,000 is exempt, of course, due the availability of the NRB.

This leaves £715,000.

At 40% IHT, the daughters are liable to pay £286,000.

This is in effect a payment of £143,000 each, although in practice it is taken from them before they receive the residual.

3.3 Inheritance tax can also apply while you're alive!

There are two main types of IHT liability. IHT taxes that arise from gifts made after death (via a will), and IHT taxes that arise from gifts made during the lifetime of the giver.

So what is the definition of a gift?

It is really anything of value – money, property, a painting, antiques, a car, John Lennon's piano…anything!

We already know that, in death, the rate of tax is 40% of the inheritance, for any part of the estate exceeding the NRB.

Gifts given during the lifetime of the giver (or 'transferor' as they are more formally known), are taxed at 20% when made to a Discretionary Trust.

Gifts not made to a Discretionary Trust are potentially exempt and we will look at these later, see section **6.5.**

3.4 Lifetime gifts

If a financial gift or estate is received during the giver's lifetime, there is an immediate 20% tax on any amount exceeding the £285,000 threshold.

Lifetime gifts can be more complicated when the giver of the gift dies within seven years of their generosity (see **4.8**).

Example 3a – IHT in lifetime to a Discretionary Trust

During her lifetime, 80 year-old Carina gives part of her estate, valued at £310,000, to her son's discretionary Trust "The James Discretionary Trust".

James's Trust is exempt from paying tax on the first £285,000. But now he will pay 20% IHT on the remainder: £25,000.

£25,000 x 20% = £5,000 tax.

So, after IHT, James's Trust will be left with £310,000 and Carina will have to settle the IHT bill of £5,000.

Note - it is possible for Carina to expect the Trust to settle the tax and for her donation to be "grossed up" for the rate of tax due.

Key Tip

For some, it makes sense to give away some or all of an estate during their lifetime.

If 80 year-old Carina lives alone and her income more than covers her living expenses, there is little sense in her holding onto a large estate.

Better for her to start making as much of a gift as she can during her lifetime.

3.5 Cumulative totals

Example 3b – Potentially Exempt Transfers during lifetime

In 1994, Carina gives her son £400,000 in the form of her second house. She pays no lifetime transfer IHT as it is potentially exempt.

In 2000, Carina gives her son £250,000 as a 30th birthday present.

In 2002 Carina 'loans' her son £15,000 for a new car but does not expect this to be returned.

In 2003 Carina gives her daughter £50,000.

In 2005, Carina dies (the above are all the gifts given by Carina to anyone in her lifetime).

The gift in 1994 is exempt since it was given over seven years ago. But the last three gifts combined exceed the NRB and as she is now dead these transfers have become chargeable.

If we ignore the reliefs available, which are examined later, including annual exemption and taper relief, the calculation of IHT is worked out as follows:

The son received £265,000, which is under the Nil Rate Band.

Her daughter gets a raw deal as with no NRB available she gets hit with the full 40% on all her transfers. She must then pay tax on her gift of £50,000. This will be 50,000 x 40% = £20,000.

As with the above example, if the giver dies within seven years, IHT isn't calculated on just single, isolated gifts. A cumulative total is made on all gifts in the seven years leading up to the death of the 'transferor'.

If the total exceeds the Nil Rate Band, then extra tax may be liable. However, the burden of tax can be lessened by personal tax exemptions (more on this in section 4).

Example 4a – Totting up the gifts

In 1996, Craig gives his son £5,000 for starting university.

In 1999, Craig rewards his son £25,000 for passing his final exams.
In 2001, Craig pays the £25,000 deposit on his son's first flat.
In 2003, Craig pays for his son's wedding, costing £20,000.
In 2004, Craig gives his son £220,000 for giving him a baby grandson!

Note - £5,000 of the wedding gift is exempt as we will see later.

In 2005, Craig dies.

All of the money Craig has given out in the last seven years is now added together by the taxman. Ignoring the gift made in 1996 (over seven years ago), the total sum of gifts is £290,000.

Provided Craig has made no gifts to others during this period the IHT liability is £5,000 x 40%. That's because the first £285,000 is exempted by the NRB.

Example 4b - Take sensible steps when you can!

OK, so let's now say that Craig still gives his son the £5,000 to help him binge-drink at university. Let's also accept that Craig then gives his son £25,000 for staying sober enough to pass his exams. We'll even let Craig provide for the next two gifts.

What comes next – though maybe a little far-fetched – is the sort of IHT planning mistake that can be easily avoided.

Does Craig need to make such a big gift in 2004? He's already given his son £70,000 in the past five years. That's personal choice, of course. But provided Craig doesn't give his son more than £215,000 over the next two years – and he doesn't give any other gifts to anyone else – then his NRB will protect him. So he shouldn't give £220,000 – it's foolish!

If he survives for more than seven years, the whole amount will be tax free. If he dies, his NRB will cushion these gifts. This strategy, of giving away gifts over time, is an excellent way of passing on your estate.

3.6 What you should know before you start making gifts

Stop…if you are planning to, or are actually giving, large sums of money to loved ones over a number of years! Before going ahead, make sure that one of the following applies:

- You don't die within seven years of giving (not a dead cert!)
- You consider the implications of your gifts on other financial plans
- Your cumulative total does not exceed £285,000
- Keep a record of all the gifts you make over your lifetime

Because, if you were to die, then the cumulative total of all the gifts you made in the last seven years would be taken into account. That's not just gifts made to your relatives – that's any gift given to anyone! If you don't make a list, or don't consider your generosity carefully, your estate could end up with a bigger tax bill than you may otherwise have expected.

There are lots of IHT exemptions – ways to avoid paying tax legally - and we'll discuss them in section **4.**

3.7 Summary

From reading this section, you should now know:

- The basic rate of IHT (40%), and the current nil tax band (£285,000)
- The lifetime transfer rate (20%)
- When IHT does not apply
- That gifts during your lifetime need careful consideration

IHT is charged at 40% on death and 20% on lifetime transfers. Lifetime transfers made within seven years of death of the transferor, or giver, will be subjected to further IHT. Planning gifts in life will greatly reduce your relatives' IHT burdens when you die.

In the next section, we'll look more closely at the different types of exemptions available in life, and in death.

But don't read the following as just a list. Think of it more as tactics, which you can combine to powerful effect.

4 When you don't pay IHT

Now you've grasped the fundamentals of IHT, let's look at all of the financial, or other, gifts you can make without being hit by IHT.

By gift, we're describing anything of significant value. Not really £20 music vouchers or the like. We can define a gift as anything with a value above a few hundred pounds, and certainly anything with a value over £1,000.

There are a number of gifts you can make which, because they are of a lower value, will help you give money away without incurring IHT.

After we've pointed these out, we'll then explore the more complicated world of potential exemptions, and the death rate tax band.

By the end of this section, you'll know:

- When you can give your money away without incurring any tax at all.
- You'll also know how to make more sensible decisions about making larger lifetime transfers in your later life.

First off, let's deal with exempt gifts that carry no IHT burden at all. Remember, as we said before, gifts between spouses (living in the UK) carry no IHT.

4.1 Your annual gift allowance

Everyone gets the same personal gift allowance. Even the Queen!

During every tax year (April – April), you can give a gift – or series of gifts – up to the value of £3,000.

And over a two year period only, you can give any amount up to the value of £6,000 at any time – in other words, you could, for example, give £4,000 one year and £2,000 the next year.

Example 5 – How the two year rule works

In August 2003, Frank gave his son, a student, £1,000 to help him pay off his overdraft.

By October 2004, the true extent of Frank Jnr's debt was clear. So Frank gifted a further £4,000.

By March 2005, Frank Jnr had straightened himself out. So Frank gave him £1,000 as a reward. Some folks never learn!

Over two years, Frank had gifted his son £6,000, completely free of IHT. As you can see, the gifts don't have to total £3,000 during each year of this period.

Example 6 - How to give more

Now, let's imagine Frank actually gave his son £5,000 in Year One and £2,000 in Year Two; a total of £7,000.

This would make £1,000 of this gift a potentially exempt transfer and so liable to IHT, if Frank was to die within seven years.

However, Frank could avoid the potential tax implication, provided he was married. He could simply give his wife the extra £1,000, who could, in turn, give her son the money!

4.2 More basic IHT exemptions

There are a number of special or one-off circumstances where you can give someone a gift without incurring any IHT in life or in death.

4.2.1 Weddings

As a parent, you can give up to £5,000 to each of your children (including step and adopted children). Grandparents can give £2,500. Brides/grooms can even give each other £2,500.

Anyone else can give £1,000. To count as an exemption, these gifts must be made shortly before or at the time of marriage. It's no use waiting until the first wedding anniversary and claiming this exemption – it won't qualify.

4.2.2 Maintenance

Any money you give to maintain your spouse, ex-spouse, children under 18 years old (or those still in full-time education), and dependent relatives, is exempt from IHT. For IHT purposes, 'children' includes step and adopted children.

Dependent relatives can include any relative of yours, or your spouse, who is unable to maintain themselves without assistance.

4.2.3 Outright small gifts

You can give gifts up to the value of £250 each to any number of people (but each person must not receive more than £250 in the same tax year).

4.2.4 Double your money with a spouse!

Married couples can both utilise these exemptions, so doubling the effectiveness. You may (or may not), control the purse strings in your marriage, but remember your spouse has exemptions that can be used to good effect (as in Example 6).

4.2.5 Military decorations

If you, or your spouse, have received any medals/decorations awarded during military service, they will be exempt from IHT. Also, compensation claims from wars that come to fruition after many years – from even as far back as World War 2 - are excluded from IHT.

4.3 Combining basic exemptions

There's no rule against you using any or all of these exemptions in the same year. So, for example, if you give your daughter £5,000 on her wedding day, you can also give her £3,000 from your personal exemption.

Example 7

In January 2005, Robin gives £250 to each of his ten friends as a New Year present (single gift exemption). In March 2005, Robin gives his eldest daughter £3,000 to pay for an engagement ring (one year exemption rule). He then presents her with £250 for an extravagant dress (single gift exemption).

By August, he has given her a further £5,000 to help pay for the 12-piece soul band at her wedding (wedding exemption). In December, he offers his grandson £2,500 to cover the costs of his honeymoon (wedding exemption).

Neither Robin nor his relatives will be liable to pay any tax on these gifts in life or in death.

4.4 Normal expenditure exemption

Normal expenditure covers you for gifts that come direct from your income. It is another useful tool, but is relative to your personal circumstance. What it allows for is regular 'normal' payments given from you to another.

A £500 per month gift made on a £30,000 annual income is not likely to count as normal. You must be able to show that you can maintain a 'normal' (again, relative to your finances) standard of living after the payment(s) is made.

This will be important should you die within seven years of making the gift(s). It will need to be demonstrated that the payments you made were regular, and they were intended to run over several years.

The payments you make must be regular, but they don't have to be equal. This exemption eliminates the chance of death bed planning (giving money under pretence that it was a regular, planned payment).

Example 8

Mr Johannsen had an annual income of £600,000. In January 2002, he set up a regular monthly gift of £5,000 to his grandson. In January 2003, he upped the payments to £5,500 per month. Mr Johannsen died in April 2004.

During the period, Mr Johannsen's grandson had accumulated £137,000.

He will not have to pay IHT as the payments received were regular, running for several years and were relative to Mr Johannsen's income.

While Mr Johannsen may escape IHT, his grandson would be liable to pay income tax as a UK resident. As the payments are regular, they are classed as income. Better that the grandson lives abroad – where he would escape any taxable income.

While it is important to demonstrate a pattern of payments, it is also possible to escape IHT if only one large payment was made before the transferor died.

Example 9

Mr Johannsen had an annual income of £600,000. In September 2004, he gave his son Rohan £30,000. His son was going to use the cash to help fund an annual charity expedition to Africa. In December of that year, Mr Johannsen died in a yachting accident.

However, Rohan was able to avoid IHT liability as he had kept a letter from his dad which stated Mr Johannsen's intentions to make annual payments to help with his son's vocation.

The key to exemption – show proof of your intentions.

4.5 Gifts to charities, associations and political parties

You won't have to pay IHT on any gifts made to UK-based charities, housing associations or political parties.

To count as an exemption, the political parties you're giving money to must have:

- At least two House of Commons' members
- Have received more than 150,000 votes in the last General Election, prior to the gift

Land given by you for national purposes/registered housing associations is exempt from IHT. And many gifts to national bodies such as The British Museum and The National Gallery are also exempt.

A full list can be found in Chapter 15, Appendix 1.

4.6 Transfers of value – how to make them work in your favour

You can't get around IHT by just giving away your valuables. Or even by selling them cheaply! What the taxman takes into account when totting up your IHT liabilities is not the cost you sold an item at, but its real value; in other words, its market value.

Example 10a

Mr Hill sells his old Formula One car to his son for just £5,000, thinking it's a great way of avoiding IHT.

Two years later, Mr Hill dies. Assessors look into this transaction and place the true value of the car – at the time of sale – at £300,000. The son will be liable to pay IHT at the full rate!

But the transfers of value rule can also work in your favour.

Example 10b

In 1994, Mr Hill gives his son a range of sporting memorabilia with a value of £3,000.

By 2000, the market for sporting memorabilia has rocketed and the value is up to £30,000!

For IHT purposes, the taxman is only interested in the value at the time of transfer.

4.7 Potentially exempt transfers

Any other gift you give in your lifetime is a potentially exempt transfer. This means that it is exempt from IHT, but subject to the following conditions: if the gift – or the sum of its parts over seven years before your death - is under the £285,000 NRB, it will not be subject to IHT.

Example 11

Knowing she was getting on a bit, Carmen gives her daughter £100,000 in 2001. In 2003, Carmen gave her only child a further £150,000.

In 2004, she deposited a final £12,500 in her daughter's account. A month later, Carmen died.

The taxman will look at all Carmen's gifts in the last seven years.

Seeing that she has made three payments, totalling £262,500 – and no other payments elsewhere - he concludes that there is no IHT to pay.

4.8 The Death Rate Band

The IHT band rates are used only if the giver of an estate or fund were to die within seven years of transferring funds.

The new death rates (as of 2005) define what percentage of the 40% IHT the receiver will be liable to pay in this event:

Number of years between transfer and death	Percentage of full tax rate
Between 0 and 3	Full rate 40% tax
Between 3 and 4	80% or 32% tax
Between 4 and 5	60% or 24% tax
Between 5 and 6	40% or 16% tax
Between 6 and 7	20% or 8% tax

So if you die, for example, three years after giving gifts that qualify for IHT, those gifts will be taxed at 32% (that's 80% of the full IHT rate).

Example 12a - Death rate bands in practice

During his lifetime, John Smith transfers part of his estate, valued at £400,000, to his daughter Jane.

Again, Jane is exempt from paying tax on the first £285,000.

£115,000 x 20% = £23,000 tax.

So, after IHT, Jane will be left with £400,000 - £23,000 = £377,000.

But three years and six months later, Mr Smith dies. Now Jane's IHT needs to be recomputed. The tax that Jane has already paid will be deducted from the new payment she owes.

Of course, Jane is exempt from paying IHT on £285,000.

This time, the remaining £115,000 is subject to death IHT, but not at the full 40%. That's because Mr Smith died between three and four years following the gift. On the death rate band, that means Jane is liable to pay 80% of IHT.

80% of (40%) IHT tax = 32% IHT

£115,000 x 32% = £36,800

Having deducted the amount of tax Jane had previously paid (£23,000) from the new IHT tax bill (£36,800), Jane is faced with a further £13,800 IHT bill to pay.

Example 12b – More death rates in practice

In March 1994, John Smith transfers £262,000 to daughter Jane.

In September 1998, John gives Jane £300,000.

In August 2005, he dies.

To calculate IHT we look back 7 years; we can first exclude the 1994 payment (11 years ago).

The 1998 payment (just under seven years ago) will be subject to 20% of the full rate, or 8% tax. All of this is subject to tax, since John willed his NRB to be used for his estate (from which his daughter will also benefit).

So with no NRB being available on this payment, the tax of £300,000 x 8% is due, which is £24,000.

4.9 Summary

From reading this section, you should now know:

- Gifts you can make with no IHT penalty
- How to make best use of all your exemptions
- How potentially exempt gifts can become IHT burdens
- The death rate bands in practice.

Next we'll discuss what typically makes up the largest part of your estate – your property – and how to minimise IHT.

5 YOUR HOME IS AT RISK …..

With all the one-off gifts, the NRB and the potential exemptions, you may be thinking there's not really much to worry about. Just give everything away, sensibly and methodically, and make sure you survive for seven years and there's no chance of IHT taking a bite out of your estate.

But your ability and willingness to make financial gifts will change throughout your life.

The need to plan an inheritance tax strategy is probably likely to come later in your life - unless you've been lucky to accumulate large amounts of wealth at an early age.

Your home's a different matter. You need to formulate a strategy now, especially if you have children. The exact strategy you choose now will probably change with your circumstances. Death can be sudden.

It's the surviving family that loses out to IHT.

By the end of this section, you'll know:

- The best way to 'own' your property
- How to give away your home without being penalised by IHT
- How to benefit from your property and reduce IHT

5.1 Giving your house away – bad idea!

One mistake some people make is having given their house away, they continue living in it.

When you're transferring large parts of your estate, but still maintaining a benefit, the transferred sum will count as being part of your estate upon your death. So it becomes a gift with reservation.

Which means it gets taxed.

Example 13 – You can't just give it away!

During their lifetime, Mr & Mrs Beckham give their son their entire estate – valued at £30M. Mr & Mrs Beckham continue to live at the family home up until their deaths many years later.

The estate does not escape IHT, since the Beckhams maintained a benefit after giving away their estate. Their estate is taxed at 40%.

5.2 Getting around reservations

You may want to get around this by giving your property to your children and then paying them commercial rent! By giving rent, you'd even lessen the value of your estate.

This may seem a clever idea, but as you will leave your children open to paying income tax on the rent, this makes the idea largely impractical.

Instead, your first consideration should be the nature of your house ownership.

For married couples, there are two ways you can own your house: joint tenancy and tenancy in common.

The basic difference between these is the balance of ownership.

With a tenancy in common arrangement, one person can own a greater or lesser part than the other.

If you have a joint tenancy arrangement, the 'other half share' will automatically go to the surviving person – regardless of a Will!

A tenancy in common ownership is more flexible - but newlyweds beware!

If your marriage breaks up you will have to ensure you change the ownership status.

Joint tenancy offers couples peace of mind - if one dies, the other will be sure to get the house.

In the rest of this section we're going to describe a number of ways you can avoid paying IHT on the family home.

5.3 Divide your home into small parts

If you have no intention of selling your property, you can turn it into shares. This way, it can't become a gift with reservation.

Providing you have owned your property for the last seven years – including both parties of a 'joint ownership' – you create a 299 year lease on it, which you make effective in a number of years time.

You can give that lease to an 'Interest in Possession Trust' (more on this in Section **6.3**). You then make your children the Beneficiaries and you/your spouse the Trustee.

As it gets closer to the time that the lease comes into effect, the value of your freehold interest in the property will reduce. If you've planned well, the amount of interest in your house will be minimal at the time of your death and will be covered by the NRB.

Key Tip

If you have misjudged the start of the lease, and you're still alive when it comes into effect, you will have to start paying rent to your children or move into smaller accommodation to avoid the gifts with reservation clause.

5.4 If you can afford to leave…

Cash rich? Then eliminate IHT by moving out of your house and then passing it on. You could buy a house below the NRB, or rent. Clearly, this is not an option for many of us.

5.5 If you get along well with your kids…

By now, you don't have to worry if you're married and you intend to pass the house onto your spouse. But what happens when she or he dies? You could leave your half share of the property – assuming it's in joint names – to your children. They will then jointly own it with your spouse.

5.6 And if not…

To avoid any potential complications (i.e. children trying to kick out the remaining spouse to get their hands on the loot), you can get the children to set up a Life Interest Trust.

This removes any interference from the children whilst your husband/wife survives. The remaining share of the property will revert to the children at the moment of death.

Example 14 – A game of two halves

Mr Greaves dies, leaving 50% of his £450,000 house in a Life Interest Trust. His wife is made Trustee and the children Beneficiaries. Mrs Greaves is free to live in the family home without worrying that her children will try and sell it.

She dies six months later. The full amount of the estate now transfers to the children.

The children have avoided IHT on the house with both the first and the second deaths as both parents - joint owners - are entitled to the NRB. Any remaining money from the NRB can be used to offset the overall tax burden of the estate.

Key Tip

Because the remaining half of the house is being passed to the children as the settlors of the Trust, it is exempt from IHT.

5.7 If you want to live with your child…

An alternative to setting up a Trust is co-ownership. This means putting the property into joint ownership with one child. So it's usually a strategy to consider once you or your spouse has passed away.

This would typically be considered a gift with reservation. But providing the child lives in the house, their share of the property will be potentially exempt.

Example 15 – Living with your child

Upon her husband's death, Mrs Greaves invites her daughter to live with her. She puts the property, valued at £600,000 in joint names.

Six months later, she dies.

Her daughter's £300,000 share is exempt from IHT.

5.8 Selling at full value

You can always sell your home to your children, at full market value. And pay them rent. Not attractive? Well, in this way any future capital appreciation will go to your offspring.

You just need to obtain a loan and offset your rent with your children's interest liability. In this way there's no gift with reservation – so no IHT liability. And there's no income tax. But there maybe a stamp duty charge. Your children will lose principal private residence exemption when they come to sell it.

5.9 Eversden schemes

In recent years, these schemes have gained some popularity. But changes in the Finance Act mean they are now liable to income tax charges.

The schemes were developed after a woman gave 5% of her home's value to herself and the remainder to Trusts, with her husband maintaining a life interest.

The husband set up a range of beneficiaries that included his wife.

The couple lived in the property until her husband's death. The Trustees sold the house and bought another house under the same conditions.

It was not a gift under reservation because when the settlement was made it was an exempt transfer from one spouse to the other.

In these schemes, the gift will still be a gift with reservation when the settled property creates an interest in possession for the donor's spouse. After this time – but before the donor's death - the interest in possession ceases and the spouse does not have a further interest in the property.

5.10 Borrow on your home

You could always borrow money against the value of your property and invest it in Alternative Investment Market shares (more in section **6.8**).

It's a risky strategy, but after two years, the value of your investment will be completely free from IHT. This is only worth considering if you have a strong link with a company – for example your son/daughter's business, etc.

5.11 Trust of debt

We will look more closely at Trusts in the next section, but you can reduce IHT on your home by setting up a Trust and 'selling' your house to the Trustees.

The amount you sell the house for is only taxable upon your death. It is not subject to an increase in payment, nor will it bear any interest. Instead, you have a 'debt' owed to you that you use to pass to named beneficiaries.

In this way you have a reserved benefit, but not an IHT charge. You also remove any capital gains charge, providing the property is your main residence throughout your lifetime.

It is not clear if using this strategy will lead to paying income tax. As you are living in the property that you have since passed on, you may well be liable. But under the Government's new tax measures (yet to be fully introduced) it is very much a grey area.

5.12 Making plans for income tax

In many cases, income tax can also be avoided through careful planning and the seven year gap.

Example 16 - Giving and living in

Colin gives £125,000 to his son Cieran in 1998. Cieran buys a flat for that money. In 2006, Colin moves into the flat and doesn't pay rent.

Colin will not be liable for income tax.

Example 16b - Misgivings

Colin gives £25,000 to his son Cieran to put towards the cost of a flat. Cieran funds the difference with a mortgage.

Colin moves in after three years. He will be liable to an income tax charge as he is enjoying a benefit in the property.

There is a way for Colin to give exactly the same money and move in – without paying income tax.

Example 17 - No income tax option

Colin ensures Cieran's mortgage funds the entire house. Then Colin gives his son £25,000 to use on refurbishments.

Colin moves in after three years. He will now not be liable to income tax because the gift was not used for the purchase of land.

5.13 Summary

After reading this section, you should now know:

- Key strategies to minimise IHT on your property
- A number of family strategies
- How to take your financial situation into account
- When income tax implications apply.

A common way of passing on your home is through a Trust. In the following section, we'll discuss what Trust options are available to you and your property. Setting up the right Trust will make a real difference in minimising your estate's liabilities.

6 WHERE TO PUT YOUR TRUST?

By setting up a Trust, you're placing assets outside of your estate. This is an area of IHT planning that became controversial in 2006 as Gordon Brown looked at new ways to tax them.

By the end of this section, you'll know:

- All the components of a Trust
- The best Trusts available
- Which Trusts suit your lifestyle.

6.1 Why Trusts?

Trusts are set up in order for you to channel funds or the value of an estate, for the benefit of your family now or after your death. Your house, your savings, your antique furniture can all be placed in a Trust now, ready to be passed on with the minimum of fuss when you die.

Instead of giving your 21 year-old daughter your family fortune now, you can use a Trust that releases the money when you think she'll be ready to handle it sensibly!

In life, you can set up a Trust fund for your children/grandchildren, and use your personal exemption (Section 4) to give the fund up to £3,000 every year, tax free.

Here are some useful definitions:

The Settlor	Person setting up the Trust
The Settlement	The 'value' (capital/income) of/within the Trust
The Trustee(s)	Family members who 'control' the Trust
The Beneficiary	Family member(s) who receive the estate at the proper time

For a Trust to be legal, you will need to ensure it is set up correctly, or else it will hold no power at all.

Setting up a Trust should be well thought out. Once you've appointed the Trustees and determined the Beneficiaries, there's no turning back - even if you've made yourself a Trustee. Trusts are governed by powerful, and inflexible, rules.

There are several main Trust types available. The Trust you will choose depends upon the size of your wealth, your personal circumstances and the relationships you have with your children.

From 2005, all Trusts have a tax rate band that applies to the first £500 income coming from a Trust. This measure will stop the need for 30,000 owners of small Trusts from completing a self assessment form every year!

6.2 Your Will Trust

Don't think that Trust funds are only for the rich. If you want to make a Will (and of course you should), you'd do best to use a Will Trust.

A Will Trust will mean you can claim your NRB and give full control of your estate to your spouse, for example. You can also set up a Pilot Trust, which guarantees any pension fund or insurance policy will be paid to your surviving spouse.

6.3 Interest in Possession Trust

Interest in Possession Trusts allow you to give money or possessions to beneficiaries. You will need to identify a beneficiary who will initially enjoy the income provided by the Trust. You can change the beneficiary and even name an alternative beneficiary for the capital.

Example 18a – A set income

Winnie transfers £200,000 into the Pooh Trust. Winnie had previously set the following annual incomes from any transfers:

Piglet to get a quarter (£50,000)

Tigger to always receive the first £10,000

Christopher Robin to receive the remaining balance (£140,000)

In the above example, each beneficiary receives a specific, pre-arranged amount – an Interest in Possession.

Example 18b – Changing a set income

Winnie transfers £200,000 into the Pooh Trust. Winnie is a Trustee, along with his brother Eeyore. They had previously set the following annual incomes from any transfers:

Piglet to get a quarter (£50,000); Tigger to always receive the first £10,000; Christopher Robin to receive the remaining balance. (£140,000).

However, at the time of the latest transfer, Tigger has a change of status and Christopher Robin has died.

As Trustees, they decide to make Eeyore receive the first £10,000. The balance will stay in the Trust.

Key Tip

With an Interest in Possession Trust, the amount is predetermined and not down to the discretion of the Trustees. This Trust will suit you if you have a wider family group, or where there is a possibility of beneficiaries changing over time.

Example 19 – Changing Possession

Harry is the beneficiary of his father's Trust. He receives an income of £10,000 per year from the fund. Harry has the 'interest in possession'.

However, Harry dies two years later. His mother, a Trustee, ensures that Harry's younger brother, Will, now receives the income.

With these Trusts, you could also arrange for more than one person to receive an equal share of income.

If you want to avoid Agatha Christie-esque intrigue and scheming within your family, it is vital that you consider carefully the Trustees of any Interest in Possession Trust.

And remember to review your Trustees in the event of death or divorce!

6.4 Return of capital with mini-Trusts

Clever use of Interest in Possession Trusts can be found by setting up a series of them, known as Reversionary Interest Trusts.

Basically, you give a large amount of cash to the Reversionary Interest Trust. This money's then divided across a series of smaller Trusts. The transfer is a potentially exempt transfer and subject to the seven-year rule.

Example 20 – a series of Trusts

Depending upon how many smaller Trusts are established, they operate in the following way:

Trust A) Income is paid to a beneficiary for one year, after which the remaining funds are paid back to the transferor

Trust B) Income is paid to a beneficiary for two years, after which the remaining funds are paid back to the transferor

Trust C) Income is paid to a beneficiary for three years, after which the remaining funds are paid back to the transferor

Trust D) Income is paid to a beneficiary for four years, after which the remaining funds are paid back to the transferor.

And so on…

Key Tip

In the above example, the transferor receives an income (actually it's a return of capital). This income is not part of the estate (as described earlier), so it's free from IHT. And as it's not strictly income, it's free from income tax too!

6.5 Discretionary Trust – how to make people nice to you

Think of this Trust as your new best friend! Giving money to one of these is treated as if you were making a lifetime transfer. They're chargeable transfers, and seemingly free from IHT.

These Trusts are well suited to IHT planning, as in the previous example, as they are generally more suitable for larger gifts or for holding shares in a business.

A Discretionary Trust is the best place to start if you're not yet sure who should benefit from your estate. It also allows you to maintain power over whether your beneficiaries receive an income or capital.

Unlike an Interest in Possession Trust, no one will be predetermined to benefit from an income. It is for the Trustees to decide what happens to the Discretionary Trust fund, and when. You never know, this Trust may give the added benefit of your family being nicer to you…

6.6 Your tenth anniversary present

While you escape IHT for the first nine years, your Discretionary Trust is – bizarrely - subject to an IHT charge on its tenth anniversary.

The value of any property in the Trust, calculated on the day of its anniversary, is added to any other non-charitable settlements made on the day that the Trust was originally set up.

The NRB is taken into account, but not any other exemptions.

6.7 Where it gets complicated…

The rate of anniversary IHT is calculated from the above and then multiplied by 3/10ths and applied only to assets held within the Trust throughout the ten-year period.

Amounts derived from assets that have been held for less that ten years are reduced by 1/40th for every year they were not part of the Trust. It's confusing without an example!

Example 21 – Discretionary Trusts & 10 year tax charge

1993
Frank had a heart scare, so he and his wife start planning their estate. Frank's brother, Fred, is about to emigrate to Australia, so Frank gives him £80,000 as a one-off payment.

1996
Frank and Betty set up a Discretionary Trust for their daughter, and any future children. They are both Trustees, along with Betty's mother. Frank transfers £100,000 worth of assets – no IHT to pay on this amount.

On the same day, Betty transfers £25,000 to her teenage step-brother, Bill. The money is placed in an Interest in Possession, making him the sole beneficiary.

1998
Frank's heart catches up with him; he dies. Luckily, the NRB covers Frank's lifetime transfers.

2006
The value of the assets in the Discretionary Trust is now £200,000.

Calculating IHT

Add up all assets	£200,000 (current value of Trust)
	£80,000 (given to Frank)
	<u>£25,000</u> (given to Bill)
Total	£305,000

Deduct Nil Rate Band of £285,000 = £20,000
£20,000 @ lifetime rate (20%) = £4,000

Now we must calculate how much of this is due:

$$\boxed{\frac{£8{,}400}{£200{,}000 + £25{,}000} = 3.73\%}$$

(Tax divided by the sum of the Trust value and gift made on same day as Trust opened) = 3.73%

Anniversary rate: 3/10ths = 1.12%

Payment due = 1.24% x £200,000 = £2,240

Note: whether Frank had died or not, the Trust would still be subject to the 10-year charge.

In the previous example, the important thing to remember is that had Frank and Betty not passed on some of their assets in this way, they'd be paying many thousands more pounds in IHT.

Remember too that transferring any funds from a Discretionary Trust will also lead to IHT charges similar to those given in the example.

Key Tip

The Discretionary Trust is the perfect vehicle for transferring your assets. You can transfer up to £285,000 every seven years – or a married couple can transfer double this.

Just make sure it's impossible for either transferor or spouse to benefit from the Trust, otherwise the gift with reservation rules will apply (i.e. it will be seen as a benefit and so subject to IHT).

You can also look to reduce the tenth anniversary charges by transferring some of the assets out of the Trust, and into the hands of the beneficiaries, prior to the anniversary.

Example 22

Successful entrepreneur Zach has set up a Discretionary Trust for his younger sister, Evie, 22. He and his wife are the only Trustees. The Trust has accumulated £1M over nine years. Zach decides to minimise the anniversary tax by giving Evie £800,000, on the condition that she invests it in property.

In this way, much of the fund escapes the anniversary charge.

While transfers made to a Discretionary Trust are considered lifetime transfers – and so subject to 20% tax – they are almost free from Capital Gains Tax.

That's because the transferor can hold over (defer) any capital gain. This can be extended by the ultimate beneficiary of the Trust, who can also hold over capital gain.

6.8 Accumulation and Maintenance Trust

A form of Discretionary Trust, which also requires an Interest in Possession by the age of 25. Income from Trust assets has to stay within the Trust unless used for maintenance, education or the benefit of the beneficiaries.

For this reason, it is best suited to grandchildren being supported during school, college and university.

Transfers here are tax free – with no tenth anniversary charge. There's also no IHT when the beneficiary becomes entitled to income, say at the age of 25.

Example 23 – Paying fees, free of IHT

Papa Scarola offers to pay for his grandson to attend private school. The fees are £40,000 per year. To avoid this gift being taken as part of any IHT calculations – should he die – he sets up an Accumulation and Maintenance Trust.

Papa Scarola has opted for this Trust, rather than attempting to claim this as a regular gift out of his normal income. This is because he has two grand-daughters who, whilst not yet old enough, he would like to benefit once his grandson finishes his schooling.

Also, whilst the value of his estate is considerable, Papa Scarola's income is now only £90,000. He may find it difficult to prove that the £40,000 is 'normal'.

6.9 Bare Trust

A Bare Trust gives full Trust rights to the beneficiary. The beneficiary can therefore decide what to do with the income and capital. As a result, tax implications are determined from the actions of the beneficiary (unless they are under 18, in which case, you the parent will pick up the tax implications).

6.10 Charitable (incl. National Heritage)

A Charitable Trust is completely free of IHT.

6.11 Disabled Trust

For the benefit of the Trust, a disabled person is defined as:

- Unable to manage their own affairs by reason of a mental problem that falls within the terms of the Mental Health Act.
- Receiving an attendance allowance or a disability living allowance with a care component at the middle or high rate.

There are some additional components such as in the disabled Trustee's lifetime, there is no 'Interest in Possession'.

Also, more than half of the funds given during the disabled person's lifetime must be applied for the benefit of the disabled person.

6.12 Budget 2006 and its new tax implications

At first sight, the Chancellor's 2006 Budget held little of interest for property investors – but look closer and it included changes that would hit people trying to protect property assets from inheritance tax.

That's because Brown announced controversial plans to tax people who put money or assets into Trusts for their children and spouses.

At the time of writing it appears that formerly 'potentially exempt transfers' over the Inheritance Tax limit of £285,000, in an Accumulation and Maintenance Trust or Interest in Possession Trust, will be taxed at 20% for IHT purposes - and additionally at 6% on every tenth anniversary.

The changes proposed by the Treasury mean that life interest Trusts set up on death will now largely fall outside the new tax charges.

So transfers to spouses and civil partners will largely stay under old rules and the new charges – 20% and 6% every 10 years the Trust is in existence - will not apply.

Trusts set up by parents for children would be able to confer the money at 25, rather than 18 as proposed initially, without the full new charges applying. There would, however, still be an additional IHT charge of 4.2%.

Labour's latest tax grab means you should revisit your Will to check whether it needs revisions.

6.13 Watch out – Cap gains is about!

Capital gains tax (CGT) is payable on chargeable transfers during a person's lifetime.

The basic rate is 40%, but it is tapered like IHT.

If you are not looking to make a lifetime transfer using the IHT exempt or benefits, then you will certainly pay CGT. But if you are using your IHT exemptions, you probably won't pay CGT.

Settlements you have made during your lifetime, may lead to a capital gains tax charge. As previously mentioned, you can delay any charge by holding over the relief, which also passes the cost on from you as the settlor to the beneficiary.

But there are consequences to holding over payments. Any taper relief accrued before the transfer will be lost.

Example 24 - Your CGT liability

Colin gives his second home to the Carmen Trust. The property is valued at £215,000.

Trustees Colin and brother Craig want Carmen, 23, to enjoy the home for her 25th birthday. Colin, 68, does not wish for this gift to be linked to his IHT Nil Rate Band.

To avoid paying CGT, Colin 'holds over' the settlement. Upon receiving the gift as a beneficiary, Carmen is liable to pay CGT @ 40% of £215,000. In the two years since the transfer, the property is now worth £250,000.

On reaching 25, Carmen 'benefits' from the property and so is liable to pay CGT at 40% - at the property's current value!

6.14 Double your Nil Rate Band with an IOU!

Providing you carefully plan your Will, and you take proper legal advice, you can actually double your NRB.

Let's say a married couple set up a Will so that all assets go to the surviving spouse. They set up a Discretionary Will Trust, leaving a sum equal to the Nil Rate Band. Whichever spouse survives would be a Trust beneficiary, along with other family members.

Once the first person dies, the money is not paid to the Trust, rather it is IOU'd. When the second person dies, the amount of the Nil Rate Band is doubled as the IOU is deductible from their estate.

Example 25 – The Widow's Loan

In 2003, Mr & Mrs Winkowski bequest their entire £4,000,000 estate to each other. They also set up a Discretionary Will Trust, bequeathing £250,000 (NRB at that time).

Mr Winkowski dies in February 2005. Mrs Winkowski gives an IOU to the Trust, increasing it by £13,000 to cover the new NRB.

A month later, she dies. The effect of this is to double the NRB since they have both ensured they kept their allowance active.

Note: This strategy can only be used if the couple are 'tenants in common' rather than 'joint tenants'.

6.15 Income tax on pre-owned assets

The Finance Act 2004 – effective from April 2005 – introduced this latest tax charge. It's designed to catch you if you're enjoying a benefit from any property passed into Trust.

As we've already mentioned, a benefit could mean that you are still living in the property.

If you want to transfer land or an intangible asset into a Trust while living in it or drawing an income from it, you will be taxed annually. The tax due will be based on open market rental for the property, or a percentage of fixed capital assets.

However, if you have a reservation of interest in the property, you won't be charged income tax. You won't be liable for income tax if the gift was from or to your spouse.

Importantly, you also won't get caught on this and IHT if the asset in question is under the gift with reservation rules.

If the asset was given before 18th March 1986, or if the taxable amount doesn't exceed £2,500, you also won't get charged income tax.

As in example 14, whereby a widow put the family home in joint names with a child, income tax will also not be payable. Finally, income tax on pre-owned assets is not applicable if you have funded life insurance policies on a Trust.

The short answer is: make sure you're not a beneficiary in your Trust and you've nothing to fear. Or, make sure it's up for IHT consideration and then it won't be liable for income tax at all.

However, it might be more prudent in some instances to actually pay the income tax in order to reduce the IHT contribution.

Example 26 – When it pays to pay income tax

Marion, aged 77, is a widow and is in good health. But she's concerned about her tax position in later life.

The family home is worth £320,000. She has been advised to put the home in a Trust with her daughter Katherine and son Colin owning 50% each of the property.

So, Marion must pay rent to avoid having a benefit. The commercial rent on the home is £12,000 per year. If Marion doesn't pay this rent, she will be taxed on the sum as though it was income. In this case, as a 22% tax payer, she will owe £2,640 per annum in tax.

But this is actually a better option than if Marion simply gave the home away after she died; if she did that, £57,000 (£320,000 minus £263,000), would be liable to 40% IHT tax - £22,800.

If Marion pays tax on the commercial rent, she will be able to live in the house for almost nine years before reaching this amount. So it may make sense, being 77, to choose this more unconventional option.

6.16 Summary

After reading this section, you should now know:

- Setting up a Trust will help you avoid IHT tax, and benefit your loved ones during your lifetime
- There are several Trust fund options available: Interest in Possession, Discretionary, Accumulation and Maintenance, Charitable and Disabled
- New taxes were introduced in 2006 so you may have to revise Wills
- You can set up Trusts (Reversionary) that can pay you an income
- The Trust you choose will depend upon your family and your objectives.

Having covered all of the basics of financial gifts and your family home, in the next section we'll look at business planning in depth and help you avoid any IHT complications.

7 HANDING DOWN YOUR BUSINESS

If you own a business, there's a chance that it will be fully exempt from IHT – now there's a relief!

Of course, with IHT it's never a simple matter.

After reading this section, you will know:

- What businesses qualify for IHT relief and at what % rate
- Ways to reduce your IHT liability on your business
- How shares strategies can reduce your IHT liability

7.1 Understanding business property relief (BPR)

To enjoy business property relief, your business must satisfy certain conditions. The relief you'll enjoy – having satisfied the conditions – is a percentage reduction in the value transferred. Tax relief applies to transfers made in life and on death and to occasions on which tax is chargeable under provisions relating to settlements without interests in possession (see previous section **6.3**).

7.2 Conditions for receiving business property relief

To obtain relief upon death, your business must satisfy the following:

7.2.1 Be a qualifying business

This means most businesses, but excludes those that rely on the individual (who would have died) to operate and so operate only for gain. For example, authors, painters, sculptors, and even stud farms are excluded from relief.

Example 27 – Art for art's sake

Pablo owned two profitable businesses. The first was as a painter, working on high value commissions for a number of rich clients.

Because of the ad-hoc nature of this work, he also had a more stable job as a painter and decorator. A business that employed several full-time staff.

On his death, only the latter business will qualify for full IHT relief as the taxman does not recognise Pablo's first job as a qualifying business.

7.2.2 Be a relevant business property

While some professions, that are considered to operate for gain only of the individual, do not qualify, the property attached to that business also does not qualify for relief.

But most businesses, and business property, does qualify. The types of qualifying businesses are illustrated in the table below, with the amount of IHT relief also given:

7.3 Rates of Business Property Relief

Transfers of value	% of relief
Unincorporated business *(sole trade/profession or share in a partnership)*	100%
Unquoted securities *(loan stock of a company when transferor has shares that give control of the company)*	100%
Unquoted shares in company not stock listed *(Includes shares traded in the Alternative Investment Market – AIM – or the Unlisted Securities Market 'USM')*	100%
Shares or securities giving control of a 'quoted' company *(stock market listed)*	50%
Land, buildings, machinery, plant in a partnership/controlled* company or in a settlement *(used solely for business purposes)*	50%

*By ‘controlled’, the taxman means that the deceased must have had the majority (50% plus) of voting powers on everything affecting the company.

Example 28 – When you’re in control

Larry, Barry and Gary own a golf course, including a mini-golf range. Larry wants to give his daughter the mini-golf course for her 13th birthday.

However, with only a third share in the business, he cannot do this and claim IHT relief.

Feeling generous, Barry and Gary devise a short-term scheme to give Larry full legal control of the business for one day. On this day, Larry transfers the land to his daughter, thus claiming a 50% reduction in IHT.

You can claim no IHT relief if the company concerned is being wound up or is in the process of liquidation when the transfer is made, unless it is to continue in some form after this process.

A qualifying business must have been owned for at least two years.

None of the above IHT relief will count if you haven't owned the relevant business for at least two years before making a transfer.

Example 29 – A gift through shares

Big Chuckle brother wants to make small Chuckle brother smile on his birthday. Instead of just handing him £100,000 in cash – thus creating a potentially exempt transfer – he gives the money in shares.

Under the business property relief rules, small Chuckle brother will have to keep the shares for two years. It's a riskier option, but it's exempt from IHT.

7.4 Exceptions to the two year rule

One exception is where a property has replaced another qualifying property. Both assets taken together would then have to have been owned for at least two of the last five years before the transfer.

If two successive transfers are made with the same property in two years (one occurring on death) and it had previously qualified for relief, then it will also be exempt.

If a widow/er inherits a business property, the ownership period includes that of their deceased spouse.

7.5 Deferring shares

You might not need to use this strategy if you're already claiming 100% Business Property Relief (BPR), see Section **7.1**, but we include this IHT strategy in case the current relief is reduced in future.

Deferring shares offers advantages over simply giving shares because it means the transferor benefits from the capital and the income of a company. Moreover, the beneficiary also gets to enjoy some voting powers in the company. And the transferor doesn't get caught out by the gifts with reservation rules as s/he doesn't benefit.

For the company owner, deferring shares means you create a new division of shares. These low value shares are given to existing shareholders. They carry no rights, but at the end of a specified period they replace the ordinary shares – with full rights and value in place.

This way, you can transfer shares with little IHT implication because the shares are initially not worth anything.

Example 30

In 2002, Colin, 67, plans to step down as Chairman of his family run company.

He wants to pass on his share of the company without IHT consequence and complication. He creates a deferred share division which means that all shareholders receive the new shares as a bonus. Colin has made the shares carry no power until 2006.

His daughter Carmen and brother Cieran each own 10% stock, while Colin owns 55%. In setting up the new shares, Colin can pass on his new shares to his daughter and brother. And in 2006, when the new shares take precedence over the existing shares, they can both enjoy more power without any IHT consequences.

7.6 Value freezing shares

This is very similar to what was described above, only this is a better strategy for investment companies.

Again, new shares are given to shareholders. They give rights to benefit from the company being wound up but only at the value that exceeds the value of the new shares. However, these shares will not qualify for hold over relief.

Deferring shares is a strategy suited to investment companies because there's much greater certainty in calculating the value of the shares. With a trading company, shares are valued on an earnings basis that makes it trickier to freeze the value of the company.

7.7 Share dividend waivers

Here's a tip for saving IHT on dividends. You can waive your dividends by creating a deed in order to pay less income tax AND escape IHT. The deed – which is basically a settlement – will enable you to divert the income to those paying a lesser rate of tax. Lower rate taxpayers get a tax credit that will completely cover the income tax.

And if you make the waiver before the value accrues over 12 months, then it will not be liable for IHT either.

7.8 Lifetime transfers on business property

If you want to avoid IHT on potentially exempt lifetime transfers, there are further conditions, in addition to those above, which must be satisfied:

1. The original property must be owned by transferee – from the time of transfer to the time of death of the transferor.
2. The original assets must continue to remain a relevant business property during this time.

Condition 2 does not have to be satisfied if the original assets were shares/securities that were quoted at the time of the original transfer; or if they were unquoted by the period in point 1, above, and gave control of the company immediately prior to the original transfer.

You are at a big disadvantage if you hold assets outside a company. Assets held by a controlling shareholder qualify for just 50% IHT relief. If you own a minority share in a company, then you'll get no relief at all.

If you and your brother, for example, own an equal share of a property that is let to your company for trade, it will not qualify for relief. What you have to do is transfer the property into the business or give it away or sell it to the company for its capital gains tax worth.

As a company gift in this way is not a potentially exempt transfer, you have to be careful not to lose out. A detailed valuation of the transferred property is advised before you decide anything. On the other hand, you could exchange the asset for shares, thus avoiding any IHT gift implications.

Let's consider a basic example:

Example 31 – How to cut £600,000 from an IHT bill!

70 year-old Mr Branson has enjoyed a number of successful business ventures in life. He still runs two small businesses and has carefully saved over £750,000 in cash. He now wants to protect his savings from IHT so that his family can continue to live in the manner they've grown accustomed to.

One of Mr Branson's businesses is an unquoted trading company. An independent travel agency, it is worth £1 million. But it is in the red by a total of £500,000.

Mr Branson's second business is a printing concern, which is hugely profitable and valued at £2,000,000. The unquoted company uses the print facilities.

Currently, Mr Branson can claim 100% relief on the first company, and 50% on the second as it is an unrelated asset. But no savings on his personal fortune.

Assuming this was all of his fortune, and his NRB was used up elsewhere, Mr Branson would be liable to pay up to £700,000 IHT!

However, if he were to transfer £500,000 of his savings to cover the company's debt, and transfer the printing plant business into the travel agency company, he would have massively reduced his IHT bill by:

- Making his personal savings exempt by paying off his company's debts (it's all still his, of course)
- Transferring his plant into the company - it now receives 100% exemption

By doing this, Mr Branson would have saved around £600,000! Mr Branson would have to be very careful when transferring funds to cover debts. If he'd transferred the entire £750,000 – and not just the debt – he could have been in danger of creating a non-trading surplus. If large enough, the non-trading surplus can disqualify you from business property tax relief altogether.

Mr Branson should also plan ahead so that in the event of selling his company, the money he has just invested comes straight back to him.

Key Tip

Death bed planning should be avoided. Once a business is sold, the proceeds become liable to IHT.

To avoid this, you could look to sell the business in exchange for shares in an unquoted company. You'd then keep 100% relief.

7.9 Other implications - Stamp duty

A land tax – and a tax on stock and securities! Don't panic! Providing the transfer of stock and securities is certified in writing – a matter of course – you will only pay £5.00 on any transfer.

For land, no stamp duty is paid. However, you must complete a self-certificate and have it stamped 'nil paid'. Silly, perhaps, but it's also important you don't forget!

7.10 Summary

After reading this section, you will now know:

- To obtain IHT relief, your business property must satisfy the following criteria: be a qualifying business, be a relevant business property, and have been owned for at least two years.
- Most businesses qualify for 100% relief, although some plants, etc, qualify for only 50%. You can increase the relief on these by careful planning.
- Lifetime transfers carry further conditions such as the transferee keeping the business property for at least seven years, and maintaining a relevant use of the property.

8 Paying IHT with insurance policies & pensions

Even if you follow a few of the many tips and strategies given in this book, you're still likely to be liable for some IHT. There's no way of avoiding it all. Unless you fancy a heavy fine that is…

To help avoid passing the IHT burden onto your family, you can always use insurance policies to help cover the liability. With a life assurance policy, of course, you pay a set fee every month to cover you in the event of death. Upon your death, a lump sum will be payable that can be used to cover your IHT liabilities.

From reading this section, you will know:

- How insurance policies can reduce the IHT burden
- The best insurance policy types available
- How pensions still make a good estate planning strategy

8.1 Policy types

You can take out insurance for yourself or your spouse. There are four main types of policies: endowment policies, single premium investment bonds, whole life and term policies.

8.2 Endowment

These have taken a beating from both the press and insurance providers themselves of late. And they're certainly not ideal for anyone elderly.

Endowment insurance offers a lump sum to you should you survive X number of years. Although it is not typical, if you die before, you can specify that a certain portion of the sum will be payable.

Endowment policies rely on the performance of insurance company investments – which have been poor for the last few years. And then there are the high commissions payable to sales folk.

On the other hand, Traded Endowment Policies (TEPs) have seen some success recently. These are 'with profits' policies that are bought and sold on. The buyer either takes on the premium or pays a lump sum.

Should the original policy holder die during the term, the new policy holder receives a payout, with bonuses. Please note that policies traded in this way can be subject to both income tax and capital gains tax.

8.3 Whole life policies

If endowment policies seem too risky, then whole life policies are far more straightforward. The value of the fund will grow over the years and it offers a fixed sum on your death, whenever that may occur (and providing you keep paying the premium).

These are popular policies to cover IHT. But consideration needs to be made on who should be insured – the first to die or the survivor? The decision will be based on who is most liable to pay an IHT bill.

Example 32 – How not to insure yourself

John has an estate valued at £4million. His wife Yoko's estate is worth £1million. John takes out an endowment policy that will cater for a significant portion of the IHT bill on his death. But he insures himself.

Instead, Yoko dies first, leaving a potential IHT bill.

Unless you're in your twenties, full insurance cover can get expensive. And you must consider the value of your estate not just now, but also in years to come.

Make sure that the final value of your policy matches a projected rise in property prices. Or else the value of your property – and so your IHT liability – might greatly exceed your insurance policy. Keep a check on your policy at least once a year.

8.4 Term policies

Term policies offer the best short-term solutions. If you want your policy to cover a specific period of time, then these policies are ideal. They're also relatively cheap since you won't receive a penny if you're still breathing at the end of the policy term.

However, there is usually the option to convert the policy to an endowment or whole life policy should you reach the end of your term still alive. This protects you against being uninsurable too.

Example 33 – Using insurance policies

23 year olds Colin and Carina have just married. Carina is five-months pregnant so Colin takes out a term policy for ten years to cover Carina and their baby in the event of his death. The value is £150,000, covering the mortgage on their home.

Aged 33, Colin survives the policy and so converts it to a whole life policy, valued at £300,000.

By the time he's 40, Colin realises that his policy no longer covers the value of his home - £450,000. He needs to adjust his policy accordingly.

8.5 The seven year decreasing policy

Term policies are particularly useful when making larger lifetime gifts in Trust.

As the settlor, you pay a premium that decreases every year for seven years. So should you die within seven years of the gift, any tax implication will be covered. Or the beneficiary can themselves set up the policy. In which case, you may want to enter into a legally binding agreement that such a policy will be used to cover any IHT arising from a transfer.

Otherwise, family disputes may leave the donor family liable – not the donee.

When setting up this type of policy, plan for the nightmare scenario – and pray it doesn't happen! You may enjoy 100% exemption for transferring certain business properties in your lifetime. But circumstances can quite easily lead to a 40% IHT charge if your death is shortly after the transfer.

8.6 Policies mean profits? Not always.

Policies tend to be set up in one of three ways: without-profits, with-profits, unit-linked.

Without-profits policies provide a guaranteed sum. Term policies are typically without-profits. With-profits schemes offer a minimum sum but will also be greatly affected by bonuses and the bonus is dependent upon the success of the insurance company.

You will pay more for a with-profits scheme, and there are no guarantees it will perform well. But there are usually annual bonuses and an end of policy term sum that is guaranteed.

Unit-linked policies operate in a similar way to a unit Trust. You buy a number of units. A capital sum will be payable that depends on the success of the fund. There are many funds to choose from, some of which offer a minimum level of cover.

Key Tip

Avoid IHT liability for your insurance policy by ensuring that someone other than you or your spouse is the beneficiary of the capital sum payable at the end of the policy's term.

8.7 Annuity payments

Annuities are an extreme solution to IHT, in that, essentially, you end up with no assets to be taxed on!

With an annuity, you give up all of your capital to an insurer who provides you with a life income. Once you die, the payments cease. Some also provide a lump sum - often equal to your original lump sum investment - to be paid out on your death.

Annuities are worth considering if you don't want to pass on your estate and you're confident of living a long time.

So an annuity may be a good option if you're elderly but in great health. One way to enjoy an annuity is to secure a loan against your house.

Example 34 – Income from your home

Marco and Jo, 70, have no dependents. They have already given their son all of their savings - £50,000; and put their antique furniture in Trust for their son's grand daughter, Evie.

Marco is in excellent health and he foresees another ten good years, at least. But he wants to continue enjoying a high standard of living.

Marco borrows 50% of the value of his £500,000 house to buy a life annuity. He uses the annuity payments as income until his death, aged 83. The payments then cease. The house is sold and the loan debt settled with the proceeds.

Marco could have further increased his income by using both an annuity **and** insurance. After buying his life annuity, he could take out a whole life policy. He puts the policy in a Trust for his son. In this way, Marco not only has an income, but he's removed the capital cost of the annuity from his estate.

Annuities are flexible: you can start them straight away, run them for a set period, and you can even defer them so they start later in your life.

But note: annuities may have some income tax implications.

8.8 Pensions as saving schemes

The death of final salary schemes and the shocking performance of stocks have rocked the pension boat in recent years.

While they are less likely than previously to be the only source of your income in retirement, pensions still offer great tax benefits and should be utilised as part of a sound estate planning strategy.

Like some annuity schemes, personal pensions can offer a lump sum payment upon death. However, it's important to note that you do not have a great deal of freedom when assigning pension capital to a Trust. Ensure you check the small print, and arrange to set up your pension in Trust, or else you could face an IHT liability.

8.9 Setting up a discretionary Trust

You can avoid IHT on a lump pension sum by setting up a discretionary Trust and converting it upon your death to another Trust type. In this way, it's not seen as part of your estate.

Setting up a Master Trust

With pensions performing so badly in recent years, and with more of us job-hopping, you are now more likely to run several pensions during your working life.

Instead of setting up multiple Trusts, it is more practical to use one Master Trust. It is far easier to receive and administer lump sums with a Master Trust.

8.10 2006 tax changes

The Government changed the tax law in April 2006. The changes will basically offer a lifetime tax relief limit, regardless of how much you contribute and how many schemes you have running. The limit per person will be a total of £1.5m, increasing year on year to £1.8m by 2010/11.

You will be able to enjoy the excess as a lump sum, with a 55% tax recovery charge. Alternatively, you can take the excess as a pension, with a 25% tax charge.

Example 35 – Over the income tax limit

In 2006, Carina reaches 65 with a combined pension fund of £1.77m. She has an excess fund of £270,000.

This additional fund will be taxed at either 55% if she wishes to receive it as a lump sum. Or 25% if she wishes to take this sum as a pension.

It will not be in Carina's interest to go too far over the allowable pension limit. Her contributions should reflect this.

8.11 Summary

Insurance policies are an effective way of making sure you don't pay IHT. But that peace of mind comes at a greater cost than any other strategy.

You're paying to avoid paying!

It may prove better for you to use a number of other strategies described in this book first, and counter any outstanding IHT with an insurance policy.

Insurance policies can also help you enjoy a better standard of life in your last few years. But don't expect your children to have much to show for it once you die. But then, that's the point!

After reading this section you will now know:

- Life assurance is a good means of covering your IHT liabilities
- There are three basic types of policy (endowment, whole life and term) and three different ways to run the policy (without-profits, with-profits and unit-linked)
- Term policies are ideal for covering a life-time transfer
- Annuities are a useful income for the elderly
- Pensions remain a useful estate planning strategy

We've now covered all of the basics, and a good many of the strategies available. You know about making lifetime gifts, passing on your home and business, and setting up a Trust.

But what do you do if you've previously made the wrong decision? Not a lot once you're dead! But your family can.

9 A SECOND CHANCE - DEEDS OF VARIANCE AND WILLS

Everyone deserves a second chance – and that applies even after you're dead!

By the end of this section, you will know:

- You can't leave inheritance planning until your last breath
- What is meant by a Deed of Variance – and how to use one
- Why you need to make an up-to-date Will

9.1 Death-bed planning

Your mum was right; you can't leave it to the last minute. It's too late for thorough IHT planning.

You certainly won't be able to mitigate IHT on any lifetime gifts made in the last three years.

But there are a few things you can do while on your deathbed. While they're limited, you do have some last minute powers.

Make sure you've used up all of your personal exemptions – gifts up to £3,000; small gifts of £250.00, wedding gifts, etc.

If you have a loan set against a business or agricultural property, either pay it off or ensure you transfer the security to another non-qualifying property. This way, you can get full relief. The relief here only applies on property value once you've deducted any mortgage.

9.2 If in doubt – change it with (deeds of variance)!

While you can't do much on your deathbed, there is quite a lot your family can do once you're dead (other than throw a big party)!

They are able actually to re-write your IHT planning – or lack of it – by passing portions of your estate onto another beneficiary.

This is achieved through a deed of variance.

The term 'deed of variance' is a misnomer since you can't actually vary a person's Will once the testator has died. And you only really need a deed for property.

What it actually means is that you can re-direct money, property or possessions that may have been left to you, to someone else.

You have to re-direct within two years of the testator dying. There are no IHT implications at all. For IHT purposes, the re-directed part of the estate is treated as if it had been made by the deceased. Both people involved in a variance must be over 18, although you can go to court to represent the interests of a child.

9.3 Why re-direct terms of the Will?

Varying or re-directing part of an estate is not an excuse for ignoring the good advice given elsewhere in this book! You should see the two years allowed to re-direct as a way of rectifying oversights – nothing more.

There are a number of reasons why using variance would be a useful IHT tool. The most common is simply to reduce an IHT burden that's been passed from the deceased onto someone else, for example, the spouse.

Example 36 – Reducing IHT burden on a spouse

Colin, 72, dies, leaving his entire £2million fortune to his wife, Carmen. Colin had two sons, but thought it would be best for Carmen to decide how much to give them and when, so he left them out of his will.

Big mistake! Colin should have tried to reduce his estate through lifetime transfers. And his NRB has been completely wasted.

So to rectify matters and reduce the IHT on the fortune, Carmen re-directs £285,000 to each of the two sons – using both his and her NRBs.

We all make decisions from the heart as well as the head. You may end up leaving someone out of your estate planning entirely. A grudge or feud with a brother, sister, child or parent can lead to some cruel or silly decisions, that are later regretted.

A deed of variance can remedy this quite simply.

Example 37 – Doing the 'write' thing

Colin, 72, dies, leaving his entire £2million fortune to his two sons. He leaves nothing to his wife Carmen.

Sons Craig and Cieran re-direct the entire fortune to their mother. They can only achieve this through an 'instrument in writing' (through a solicitor).

You don't always have to wait for a relative to recognise poor or unfair IHT planning in order to rectify the situation. You can actually make your objections known to the solicitors looking after the deceased's estate.

9.4 Provision for Family and Dependents Act (1975)

Under the Inheritance (Provision for Family and Dependents) Act 1975, you can argue that the Will has not made proper provision for you. So if the two sons were not willing to be so generous in the above example, Carmen could take the matter to court. And she would have a pretty strong case.

9.5 Where there's a rule, there's an exception

There are some parts of the deceased's estate you can't vary. If the deceased was receiving a benefit such as by living in his house, then you can't vary it. The same is true of an interest in possession Trust.

Example 38 – When variance is not in your interest

Colin, 72, dies, leaving a Trust fund worth £1million, which he had a lifetime interest in, to his daughter Carina.

Carina now has an absolute interest in the Trust. Carina wants to share this with her brother Craig. But she can't unless she's wants to be hit by IHT.

9.6 Multiple variations

Of course, for the purposes of IHT post-death planning, it can be advantageous to you to set up a number of variations. While this is legal, you will lose to IHT on any further re-directions of a re-directed property whether in or outside of the two year limit.

9.7 Variations after the inheritor's death

So what happens if we are left something in a Will and then you die within two years? What can be varied then? Well, quite a lot.

There was a case in 2002 where an elderly lady died, leaving a life interest to her friend, and housemate, who continued to live in the deceased's property. But then her friend died within two years. So the solicitors of the first lady varied her Will as if the second lady hadn't received an interest in the first place.

9.8 Implications of variations

You won't have to pay stamp duty on land re-direction, but you'll have to pay 0.5% stamp duty on shares and securities. A re-direction of value does not change an income tax implication. Any income tax charge payable on, say, a Trust fund will still be payable after the variation.

If there is any additional tax due after the variation, you must pay it within six months, or else you will face a £3,000 fine.

9.9 Other IHT angles

Deeds of variance are not just useful for righting wrongs or using up a dead partner's NRB. You can also use the two year period to pass on any increase in assets, free of IHT.

Example 39

Carmen left her husband Colin a £350,000 estate. Within 12 months of her dying, the estate has doubled in value. Colin writes a deed of variance so that the additional £350,000 will pass on to her children without any IHT implication.

9.10 The importance of a Will

If you haven't already, you should seriously consider making a Will. Soon. Not in ten years' time!

If you don't make a Will, the people you want your estate to go to might not get it when you die.

Deeds of variance can right many wrongs; but they can't solve intestacy (dying without a Will).

The law works in mysterious ways as we have seen already (ten year anniversary charges on Trusts? Madness!).

Without a proper Will, you can't list all of your valuables. By proper, we mean one that has been correctly administrated by professionals. Without this list, you can't benefit from your NRB.

How will you ever know how much you should be giving away in your lifetime. You can't play the game without a playing field. Your Will gives you the playing field and helps you to play the game of giving away your money.

Through a Will, you can also appoint guardians to look after minors should you and your spouse die in unexpected circumstances.

It's also the place to set up a Trust to place your assets that can be used by the prospective guardians to raise your children. A Will is administered by a team of Executors.

They will register your death, grant a death certificate and find your Will. They will also be given a Grant of Probate by the Court in order for your Trustees to execute your Will. Your Trustees will be responsible for paying IHT and any other outstanding debts.

9.11 No Will power? This is what happens!

If you die without making a Will, the following will automatically happen:

- Your spouse will get all of your estate if it's worth less than £125,000.
- Your spouse will get everything if you have no other surviving relatives (e.g. children, parents, siblings).

If you have children

Your spouse will get up to £125,000; your children get the rest. Your spouse gets a life interest in this (and can take the interest). If your children die before your spouse, their children are entitled to the remainder.

You have no children, but relatives?

Your spouse gets up to £200,000. Plus half of any amount over £200,000. The remainder goes to relatives in this order: parents, brothers/sisters, half-brothers/sisters, grandparents.

Not married with children

If you are not married but have children, and you die before your partner, your estate will be passed to the children. When they die, their children will get the estate.

Not married, no relatives

The biggest blow of all! The Crown will get your estate!

9.12 Summary

Deeds of variance are both a get out of jail card and an IHT planning tool rolled into one.

After reading this section you will now know:

- Deeds of variance must be made within two years
- A deed of variance can be used to take advantage of an NRB
- A deed of variance can also be used to pass on asset growth
- Making a Will is a crucial part of estate planning

10 PLANNING IHT OFFSHORE

Creating a settlement outside the UK has no obvious IHT benefits. But it's a useful tool when planning your estate and can be used to serve Trustees or beneficiaries who are resident outside the UK.

Offshore accounts do bring benefits. In some jurisdictions, such as Jersey or Guernsey, you can accumulate income in Trusts for longer than the UK. So, that's helpful if your beneficiaries are very young or unborn and you do not wish them to become entitled until they are 25.

The requirement for an insurable interest does not exist in many offshore jurisdictions. It is therefore possible to insure multiple lives, for example, parents and children.

By setting up an offshore settlement, you are also avoiding the potential for exchange controls laws that could come into effect in the longer-term.

10.1 Tax consequences

There is no direct IHT consequence though for creating an offshore settlement. Your transfer will be chargeable during the lifetime of the settlement in the normal way.

Likewise, there is no reason to set up an offshore settlement for purely capital gains reasons. With offshore settlements, you cannot claim hold-over relief on the transfer of assets to Trustees. So you may be open to an immediate capital gains tax (CGT) charge.

CGT will be taxable on a UK resident or Ordinary Resident (OR) for the growth in the Trust. If they are non-UK resident or Ordinarily Resident they will not be subject to UK tax if the Trust is offshore.

If the Trust is offshore as is the beneficiary, there will be no UK taxes to worry about.

10.2 Offshore insurance policies

Insurance policies can be created both on and offshore. The advantage of offshore policies such as single premium bonds is that they provide a tax deferral. You can gross-up income and capital gains.

You can hold a UK or overseas based policy within an offshore insurance bond, and still provide gross accumulation of income and exemption from CGT on anything made with the bond.

But a new European Union directive that comes into force in 2005 changes the law and means that you will now receive a 15% annual tax bill if you are to set one up.

The Government has sought to tax personal portfolios, but bonds, unit Trusts, hedge funds and other collective investment funds are still permissible, allowing income to be taxed when the profits arrive in the UK, rather than being taxed on the capital gain within the portfolio.

If the policy holder is not a UK resident, then an offshore policy is attractive as it will fall outside of IHT.

10.3 Offshore protection

The amount of offshore protection on your policy will differ from one country to the next. In the event of the policy's collapse, you're likely to get most of your investment returned if your policy is based in Europe. But make sure you check it out first.

10.4 The Isle of Man Trust

A slightly bizarre and risky, but nevertheless potentially very powerful means of eliminating IHT involves setting up a Trust with relative strangers in the Isle of Man (IOM).

Through a solicitor, you identify a resident of the IOM who already has an Interest in Possession Trust running for the benefit of his own family (also IOM residents).

Through such a Trust you can buy out the interest in possession thus protecting your estate. But you are not allowed to give any money directly to such a Trust.

Sounds complicated? Have a look at the example that follows.

Example 40

In 2001, Colin borrows £450,000 which he secures against the value of his estate. With it, he buys Craig's interest in possession Trust, which has been valued at this amount. Craig is an Isle of Man resident.

The Isle of Man-based Trustees invest the loan with a view to generating a higher return than the loan's interest.

In 2006, Colin dies. But the IOM Trust – and therefore Colin's estate - will be exempt from IHT. The Trustees of the estate then liquidate the investments and pay the money to Colin's children. Colin's children then repay the loan.

10.5 Offshore asset conversion

Asset conversion is another good means of reducing IHT on a settlement. It's ideal for offshore Trusts and non-UK Trustees.

Example 41

In 1996 Colin, 55, placed his second home into a Discretionary Trust for his sister Carmen, who lives in Jamaica. In 2005, the Trust is valued at £300,000.

To avoid both an IHT implication, and the ten-year anniversary charge, Colin can sell his house and buy a business or agricultural property instead. This provides relief without incurring a UK-based capital gains charge.

Key Tip

When converting assets to either business or agricultural property, take care of the effect that this has on an immediate CGT charge. Clearly, incurring a CGT charge now of 40% produces little or no gain compared to leaving the asset in your estate and paying 40% later.

10.6 Non-domiciled residents

If you're not a resident of the UK, but you hold assets here, then only the UK-based assets are liable for IHT. That's quite different to UK residents whose entire assets – UK or otherwise – are ordinarily subject to IHT.

10.7 Summary

Offshore policies and Trusts offer some IHT benefits, more so to non-UK domiciled beneficiaries.

After reading this section you will now know:

- Income can be accumulated in Trust for longer
- You can defer taxes with offshore Trusts
- You can convert assets to avoid IHT.

11 LIFETIME PLANNING – CASE-STUDIES

Planning your estate is less about you and more about taking care of your family.

Because it seems as though you get no benefit from it, you might not want to start planning now. But there are so many ways to get caught out by IHT that it makes sense to plan from the moment you have significant assets.

The following case-studies are meant to be as exhaustive as possible while trying to maintain a real-life feel.

The years are included only to give a context; any of the different years could apply at any time.

Read them to see how the strategies we have talked about in isolation can actually work rather well together.

Throughout your life, you will need to change these strategies to suit your circumstances.

11.1 Case Study One – The Davison family

1972

Colin is 19. His father has just died, leaving Colin £10,000. Colin uses the money to buy a flat in London.

Colin starts university. He has no income, other than the money he receives from his mother.

At this point, there is no urgent need for Colin to begin making provisions for his estate. Providing he has relatives, they will inherit his flat should he die.

However, Colin would be sensible to make a short Will ensuring that his flat goes to who he chooses (it will automatically go his mother first).

If this were to happen today, he may be unwise to make the property out to his parents, especially if he has brothers or sisters. That's because the property would be included as part of his parents' estate, possibly causing them IHT complications.

Of course, a deed of variation made out by his parents could fix Colin's oversight were he to pass his property on in this way, upon his death. The deed of variation would rely on Colin's Executors receiving good tax advice.

1975

Colin is 22. The value of his property is now £15,000. He has a regular, small income. Colin marries Carmen and they live in his flat. Carmen brings £5,000 savings and a painting worth £3,000.

If Colin had already made a Will, then he should amend it to cater for Carmen. If he didn't make one before, then he should do so now. He would be advised to set up a Will Trust, giving Carmen or other Trustees full control over their estate.

Colin has a work-related pension and makes additional contributions every year.

1988

Colin is 35. He has since moved into a house worth £100,000. He has two daughters, Carrie, 10 and Carina, 2. He has a good salary. The couple's joint savings account is now worth £100,000. The value of the painting has rocketed to £25,000.

Colin and Carmen would like to send both children to private school – expensive, but manageable on their income.

So they could now consider using their savings to set up an Accumulation & Maintenance Trust fund. The fees are £6,000 per year. This way, once Carrie has finished private school at age 16, the fund can still be used to pay for their youngest daughter's education.

Any remaining funds can be used by the children once they are 25.

Colin should ensure his Will is adjusted so that his children benefit according to his and Carmen's intentions.

Colin now considers an insurance policy, to cover the IHT liabilities his estate may be open to in the future.

As Colin considers himself still young, he doesn't want to pay too much for a policy. For this reason, he might go for a level term policy which would cover him for the next few years. He could then review his circumstances.

Colin will probably want to cover the outstanding mortgage on his home at the same time. To ensure he does not pay IHT on the insurance money if he were to die, the policy should also be written in Trust.

Colin will want to review this with his financial advisor.

A little more expensive, but probably a more sensible option, would be to take out a convertible term policy. Doing this protects Colin from being uninsurable at 'normal rates' through illness or injury – affecting his chances of an endowment policy that he may need for a larger mortgage.

Colin's brother is 40. Colin gives him a watch worth £3,000. This can be done without any tax consequences; Colin is using his annual personal exemption.

2000

Colin is 47. He has since made a move to a house with a value of £450,000.

Both he and Carmen are working. They have amassed a new savings account of £50,000. The value of the painting is now £60,000.

Carrie is 22 and has just finished university. She has just got engaged to Larry. Carina is still attending private school, funded though her parents' Trust.

It's about time Colin reviewed his insurance premium, as the value of his house has increased significantly.

With his daughter poised to marry, he has agreed to foot the wedding cost - £20,000. He can do this with minimal IHT implication:

- He gives Carrie £5,000 as a tax-free wedding gift.
- A further £12,000 can be made up of 'two-year' personal exemptions from him and his wife.
- A further £500 can be given from him and his wife as a small gift.

That leaves £2,500 open to IHT, but only if Colin dies within seven years.

Colin wants to spend the money he has been saving on a big holiday to celebrate his 50th birthday. He has no intentions of creating a Trust for it!

Having put off any plans for her valuable painting, Carmen should now consider channelling it into a Trust, since she has no intention of selling it. It may be beneficial for Carmen to place this in a discretionary Trust, as she is not yet sure who should benefit from it.

She would be advised to move much of the funds out of the Trust before the ten year anniversary charge hits her in 2010.

2002

Colin is 49. His house is now valued at £570,000. He has been diagnosed with cancer. It is not considered terminal, but Colin wants to ensure his affairs are completely in order. His savings are now worth £90,000.

Colin is still planning to spend some of these savings on his 50^{th} birthday. He may find it prudent to send the bulk of this money to Carmen's discretionary Trust for now.

2005

Colin is 52. He survived cancer and has just returned from a six month tour of the world with his wife. His house is now valued at £800,000.

Both daughters have left the family home. His eldest daughter has produced a grandson. Colin and his wife no longer have a need for such a big house. They buy a bungalow for £400,000.

Now he has £400,000 cash. He is still working, and so is Carmen. Carmen's painting Trust fund will see them comfortably off in retirement.

Colin could ease his IHT burden considerably by making gifts to his children.

Having survived cancer, he is confident of surviving at least another seven years.

He could make gifts of, say, £130,000 to each of his daughters. That would be under the lifetime NRB. And if he outlived the seven years, there would be no IHT at all.

He could use the remaining £200,000 to invest in his company, of which he is now a Director. The company is quoted on AIM – the Alternative Investment Market - and therefore, after two years, the shares would be exempt from IHT.

This strategy is only recommended for Colin since he is already financially secure and has alternative plans for his retirement (pension and Carmen's Trust). The element of risk is therefore balanced by the benefits.

11.2 Case Study Two – Joanne's fashion business

1970

Joanne is 28. She has no savings or property. She is a self-employed freelance fashion designer working mainly for friends and family.

With no possessions to speak of, Joanne does not need to consider estate planning. But she should certainly ensure she is contributing to a pension.

1972

Joanne is 30. She has been offered a full-time job in London, designing for a popular high street chain.

Joanne obtains a mortgage on a flat. At this point, Joanne should begin considering making a small Will. She has no parents but two sisters.

If she didn't make out a Will, her possessions would pass to the sisters both equally. However, Joanne does not get along with her youngest sister and does not wish to give her anything. A good enough reason to make a Will!

1975

Joanne is 33. She has decided to quit her full-time job and go freelance with her savings of £1,000.

Now a businesswoman, Joanne needs to take the planning of her estate very seriously. At present, she probably does not qualify for business property relief since the business is solely her skills – that is what clients are buying (see section 7.2.1).

She must take appropriate insurance on her business assets.

1979

Joanne is 37. She has married Cameron, also a fashion designer. They work in partnership with each other. The business is doing well and Joanne also employs two further full-time staff.

The business would now qualify for 100% BPR. As joint owners, Joanne and Cameron should ensure they make a Will.

1989

Joanne is 47. Her fashion business is now valued at £2million. Her house is valued at £250,000.

Since she can afford it, Joanne should consider an insurance policy that will cover much of her IHT liability. Because she has a bigger IHT liability, Joanne should probably consider a without-profits policy that guarantees her a sum and is not linked to unpredictable investments.

2005

Joanne is 63. She wishes to retire with her husband. Her fashion business was shaken by the last two recessions, but it's now valued at £4million. Since Joanne has no dependents and no surviving relatives, she wishes to pass the business on to her employees but still draw an income.

So she places the business into a discretionary Trust, allowing her to change her mind in the future. But if she had passed it on now, and survived two years with the new ownership status remaining the same, the business would be fully exempt from IHT.

11.3 Case Study Three – Shaun: more money than IHT sense?

1985

Shaun is 23. He is a smart IT whiz kid. He has started up his own software company during the start of the computer game boom.

He lives at home with his mother (mother/father divorced). He runs his business from home.

At this age, Shaun should certainly make sure he has a good accountant. But as his incomings are relatively small and he certainly has no business property, no real IHT planning is needed.

He might want to consider a pension and/or an insurance policy and should contact an IFA to discuss this.

Perhaps he should also look to a mortgage advisor to see what deposit he needs to purchase his first home, whether it is to live in or let out (after all he has read the Property Secrets titles and is keen to make a start as a Buy-To-Let investor!).

1990

Shaun is 28. His software has been successful and he has made the transition to 16-bit computer games at the right time.

He now has two staff and has signed a number of key distribution deals.

His business is worth £1million.

He still lives at home with his mother although she is getting a bit worried he will stay for good! Shaun has made the jump to purchase three buy-to-let properties and they are making substantial capital growth.

At this stage, Shaun must consider a Will Trust. He has no dependents but a great relationship with his (young) mother and his father. If he doesn't specify how much he wants each to get in the event of his death, it could get ugly for the divorced parents.

Shaun should also make sure he has insurance, since his liability will only increase with the business and he wants to ensure his life is covered.

However, Shaun chooses not to make a Will, or take out insurance.

1995

Shaun is 33. He's finally moved out of his mother's home, and into his own flat with his new girlfriend, Clare.

His business now has its own premises. He now also owns a factory for packaging his software. The factory is also leased to a separate company and so remains, for the time being, outside of Shaun's company assets.

He owns three buy-to-let properties.

At this stage, Shaun has to have a Will. If he were to die now, Clare wouldn't get anything. Not even the flat they share. It would all go to his parents and could be very messy.

Also, his factory would only qualify for 50% IHT relief, so he would be advised to ensure it was part of the company assets.

His personal fortune is growing into several million pounds; that means many thousands of pounds of IHT liability in the event of his death.

He can plan against this by putting monies in Trust, investing in shares and making lifetime gifts.

2005

Shaun is 43. He is still unmarried but remains with Clare and their new baby daughter, Carina, in a three-bedroomed house.

His business is now worth £8 million. His factory is valued at £1.5 million. His home is worth £1.5 million. He has equity in the properties of £80,000. He also has two cars worth £60,000.

Shaun still hasn't made a Will. In the event of his death, his parents would get everything. This is further complicated by a strained relationship between Shaun's mother and his girlfriend Clare.

He hasn't taken out insurance either. Nor has he brought his factory as part of his main business.

Let's work out Shaun's IHT liabilities, if he were to die today:

Total value of Sean's estate: £11,140,000

Total exempt from IHT:	£8 million business (100% ownership of business)
	(only 1/2 of the factory) £750,000
	£263,000 NRB.
Total liable for IHT:	£2,127,000

Total IHT due: £850,800

That's a massive part of Shaun's disposable fortune that will disappear because of his poor planning/ignorance/laziness!

11.4 What should Shaun be doing with his money?

Well, there are many options open to him, but setting up a Will Trust to ensure his girlfriend gets a fair share would be a start.

He must bring his factory into the company, which will then increase the value of the shares and increase the factory's exemption from IHT to 100%.

He should set up a Trust to pay for his daughter's education.

He should also be considering investing in stocks, shares or securities to generally spread his portfolio.

Above all, he should be making it clear to his loved ones his financial position and how any taxes faced in the event of his death will be met. In this way, he is making it much easier for his family to grieve while administering his estate. And that way, they can remember Shaun for all the right reasons.

12 YOUR IHT QUESTIONS ANSWERED

Many people have asked for inheritance tax advice on the Property Secrets' tax forum. Here are some of questions and answers.

i) There has been much debate about whether AIM-listed (Alternative Investment Market) shares qualify for Inheritance Tax Relief.

We understood that provided AIM shares qualified as being business assets of a trading company, and they had been owned for at least two years, they were free of Inheritance Tax (and also got reduced Capital Gains Tax) because they were 'unquoted' shares.

But the Investors Chronicle claims that very few AIM shares (between 90 and 120 out of 1500 companies) qualify for IHT relief. This is because they are also quoted on other stock exchanges and hence count as quoted shares.

Can you clarify the situation?

I am certainly not aware that the rules have changed. To qualify for business property relief, the shares must be, and remain, unquoted.

Being quoted on the AIM is not treated as being 'quoted' for the purposes of BPR.

Do-it-yourself investment on the AIM for IHT purposes simply compounds the risks in an already risky area.

Investors seeking to use the Alternative Investment Market for IHT planning should use a specialist AIM IHT Portfolio manager, and should be advised by a financial planner experienced in this area of IHT planning.

ii) I am a UK domicile and resident and have created a UK Bare Trust, for a beneficiary who is non-UK resident for tax purposes. Assuming this is done through an investment bond, and a chargeable event occurs while the settler/donor is alive, who is liable for the chargeable event?

Is it:

a) The beneficiary and therefore there is no tax liability because the beneficiary is a non-UK resident for tax purposes

Or

b) The donor/settler because as the beneficiary is a non-UK resident, the tax liability falls back to the UK settler/donor?

Bare Trusts are transparent for tax purposes so the chargeable event is always chargeable on the beneficiary.

iii) I own my house and the deeds are in my name. My second husband lives with me although he has no share of this property.

If I should die first then I would like my husband to carry on living in the house but to transfer the deeds over to my children from my first marriage.

How can I protect the children's inheritance legally and ensure there are no tax implications?

Your Will needs to give your husband a life interest in the property, so that he can live there if you die first.

He will not have control over who gets the house subsequently, your Will continues to do so. And if it says so, then the house can be divided between your children.

iv) I am the executor for my late father's estate. I lived in his house and for a number of years paying the gas, electricity and phone bills and also contributing to the council tax.

Over the last five years I have also paid out about £7,000 on double glazing and other home improvements, not realising that my father had sufficient capital to have paid for these items.

I now find that I have to pay inheritance tax.

Can I claim that the £7,000 was in fact a loan and is now repayable?

It does not seem right that I paid income tax on my earnings to pay for the improvements, VAT on the improvements and now have to pay inheritance tax on the house which without these improvements would be worth less.

Does being a resident in the house give me any way of reducing the value of the house for inheritance tax purposes?

To obtain a tax benefit you would need to be able to show the payment as a loan, and in the absence of any paperwork to that effect this will be difficult – so, unfortunately, the Revenue will almost certainly deny the IHT savings.

v) A sum of money is put into a UK investment bond and held under a Bare Trust for the absolute benefit of only one beneficiary.

The settlor dies. Later on the Trustees wish to assign the investment bond outside of the Trust, (deed of assignment as an absolute gift) to:

a) The beneficiary

b) Someone other than the beneficiary.

The bond is then surrendered. It has made a gain.

Questions:

In the case of option A, could the beneficiary make a deed of assignment to someone else before the bond is actually surrendered?

Would the Trustees be permitted to effect option B?

The idea behind this is to avoid as much tax as possible on the gain on the bond, because the beneficiary is actually a higher rate tax payer.

This all sounds very complicated but the answer is simple. The taxation on a Bare Trust is on the beneficiary in every case.

Since the beneficiary is able to break the Trust to obtain the assets, there is no need for a Trust - an absolute gift would have sufficed.

vi) I am immigrating to Australia this year, and was wondering about the tax implications.

My mother, who lives in the UK, has two properties and other assets that take her estate past IHT threshold.

Australia has no inheritance tax, but they do tax on income and the increase in value in assets on worldwide estates.

Are there any tax avoidance techniques I can use that would work to get the best out of the tax situation in both countries?

In Australia you will pay tax on overseas income and pay Capital Gains Tax on sales of overseas assets (with a discount for assets owned over one year). There is no tax-free threshold for CGT.

If you are left a house in someone's Will that was their primary residence then special rules apply. You should consult the Australian Tax Office website www.ato.gov.au

Foreign Investment Fund taxation (search on FIF and Foreign Investment Fund) also exists in Australia.

So you should carefully consider whether you wish to transfer your UK pension Funds and investigate the options before you leave.

Transferring a fund within six months saves you tax, but you should be aware that once your pension fund is in Australia it is staying there - so too bad should you decide to return.

I cannot emphasise enough the importance of spending time on the Australian Tax Office website and familiarising yourself with how the taxation system works there before you arrive.

Despite huge numbers of Australian residents coming from overseas you cannot assume that a high street taxation advisor here has any degree of familiarity with rules and regulations on all matters of taxation.

vii) I hope someone can offer a bit of advice on 'Gifts Out of Income'. My father has moved to a nursing home following a stroke and I have an Enduring Power of Attorney for his affairs.

It has become apparent that his assets will exceed the IHT limit by a significant amount. He also has income from state and company pensions, share dividends and bank interest which goes a long way to paying the home fees.

In order to reduce this capital over time can his income be gifted to me, his only child and beneficiary of his will - with home fees paid out of capital?

I understand the limits of my authority under the power of attorney but believe the Court of Protection can approve actions to reduce IHT. Is this correct and how does one organise this approval?

Any advice on this or other options to get below the IHT limit would be gratefully received.

Assuming the power of attorney is registered, the attorney could make an application under section 8 of the Enduring Powers of Attorney Act 1985 to make tax efficient gifts.

An affidavit is required in support – and specialist advice should be sought.

However, you mention that the income goes a long way to paying the nursing home fees, implying that it does not cover the fees altogether.

If that is the case, gifts out of income can not be made, as they are only IHT efficient if made from surplus income.

Any gift (sanctioned by the court or not) would almost certainly be seen a deliberate deprivation of assets by the local authority and it would resist any attempt by you to claim that it should be covering the fees (when your father's assets reached that low level).

You could explore the possibility of IHT efficient investments such as AIM shares.

Again specialist tax and investment advice would need to be sought.

viii) I read somewhere that the value of a business you own for at least two years does not count for IHT calculation - which includes any property in the business.

Does that mean properties can be transferred to businesses to minimise or avoid inheritance tax? And, if this is possible, what taxes are likely to be incurred for doing this?

In very general terms, if you own a share in a trading business and have owned it for more than 2 years, then the value of your interest should be exempt from IHT.

Transferring non-business assets to a business does not generally exempt those assets from IHT and, in fact, doing so could turn a trading company into one which holds investments, in which case none of its value would be exempt from IHT.

If such transfers were made, Capital Gains Tax would also be an issue.

ix) My elderly mother lives alone in a property which she owns and has a value of about £360,000. She has additional assets in the region of £300,000.

If she makes a gift of the property to my sister and I in the form of a Potentially Exempt Transfer (PET), with the understanding that she continues to live there but pays a full market rent, does the following apply:

a) The PET (property/gift) is subject to the seven year rule ie: if inheritance tax becomes due within the seven year period the transfer remains in the estate for tax calculation purposes, and any inheritance tax due would be reduced on the sliding scale?

b) Would the house value for inheritance tax calculations be the market value at the time of the transfer or the market value at death?

The key here is to make the transaction as watertight as possible. So get an independent valuation of the property at the date of gift and a market rate rental assessment.

Rental reviews should also be carried out from time to time – a solicitor can advise on this, as the Revenue can get fussy about the figures, don't make assumptions.

The value of the gift as a PET is the value at the time of gifting; hence a proper valuation is most important.

Taper relief on the PET only applies to the value of the gift in excess of the nil rate tax band, so in this case taper relief on £75,000. (£360,000-£285,000).

On death, the earliest gifts made in the seven years prior come into the calculation first and therefore swallow up the nil rate band.

So for example, if your mother has made other gifts in the last seven years up to £285,000, aside from her home, the house will receive full taper relief.

x) An elderly couple, a male, aged 83, with a spouse aged 79, have a state pension plus a company pension, which together permits a very comfortable lifestyle. Both the couple are in good health.

Their property is valued at £250,000. They have savings in the region of £150,000 of which the interest is heavily taxed. Some IHT will therefore be due on their death.

It has been suggested that if they obtain a 'purchased life annuity' with the £150,000, then this would result in a substantial increase of income of around £20,000 yearly. And due to the return of capital element most of it would be tax-free.

This would enable them to give to their children regular 'gifts from income' of up to £20,000 yearly (without down grading their current lifestyle: gifts that are not treated as Potentially Exempt Transfers (PETs).

Their home is below the £285,000 level for IHT. Their pensions and the annuity would die with them and any IHT would be avoided. It is something of a gamble as they may die within a short time; but is such a course of action legal.

The exemption for 'out of income' requires the income to be taxed income.

Since, as you point out, most of the income from a purchased life annuity is return of capital, this income would not be eligible for this purpose.

It works in the same way as 'income' (actually withdrawals) from a life assurance bond is not able to be used for this purpose.

On the face of it, the total assets are £400,000. It should be possible to use both nil rate bands through their Wills to remove the IHT liability altogether.

Don't forget that if a Will Trust is used, the surviving spouse can still benefit from the asset.

xi) My mother is just about to sell her home, which I half own as an Interest in Possession Trust.

When I get my half of the money it is treated by the Revenue as a Potentially Exempt Transfer (PET).

If I then use it to set up a Discretionary Trust, which happens to pay the income out to my mother, does that invalidate the PET? (ie. If she dies after seven years does the value in the Trust become mine without IHT?)

Assuming you are the beneficiary of the Trust and not your mother, then you will not get half – but through the Trust you will probably be entitled to receive the income from half the proceeds.

The Trust document will tell you who gets the capital after your death. No PET is involved.

If the part you own is in a Trust and you are the beneficiary it is not up to you how that could be restructured, it is up to the Trustees under the powers given to them by the Trust deed.

Assuming they could do this, it would be a lifetime chargeable transfer by you (the life tenant) and to the extent that the values involved exceed your (the life tenant's) nil rate band there would be an immediate tax charge of 20 per cent.

xii) I am the sole beneficiary and executor of an aunt's will. Her only assets are in bank accounts that are held in joint names with me (although the money in them was all hers).

I do not need letters of administration, there will be no IHT to pay, but do I still have to complete an IHT 205 form?

Technically the answer is yes as there are assets in your aunt's estate. The fact that you do not need to obtain a grant of probate does not negate the requirement to produce the form to the Revenue.

Submitting the form would give you the comfort of knowing that you had complied with the rules and that there is no tax to pay (the assumption here is that the value of the assets in the estate are below the nil rate band amount, currently £285,000).

xiii) I would appreciate any clarification on the following IHT scenario. A husband and wife have the following assets:

A jointly owned house valued at £200,000

Shared bank accounts of £10,000

Husband’s bank accounts of £130,000

Wife’s bank accounts £100,000

Joint Shares of £10,000

Husband’s shares of £20,000

Wife shares of £10,000

All outstanding debts paid.

The total assets of the husband, including his share of the property and joint bank/share accounts amounts to £260,000.

The total assets of the wife, including her share of the property and joint bank/share accounts amounts to £220,000.

In a situation where the husband dies and leaves no Will, would the following be correct?

1. The Husband’s chattels (excluding property) would automatically be left to the wife.

2. The wife would be entitled to the first £125,000 of the husband’s estate tax free, i.e. the property value of £100,000 plus £25,000 in cash and shares.

3. Of the remaining £135,000, the wife would have an interest in half of this (£62,500) with the remaining £62,500 being shared by their son and daughter.

4. On the death of the wife the £62,500 for which she had the benefit is shared by their son and daughter.

If the above is correct, will items 3 and 4 be excluded from any IHT tax as the total estate is less than £285,000.

The jointly owned property would (assuming it is held as joint tenants) pass automatically to the surviving owner and would not figure within the assets available to fund the £125,000 statutory legacy. The same applies to the joint bank accounts.

The husband therefore has £150,000 of assets, and £125,000 would be used to fund the statutory legacy.

Of the remaining £25,000, half is for the children at aged 18, half is on life interest for the wife and can be a gift over to the children at 18 on her death.

On these figures no IHT is payable as only the half passing to the children is taxable, and that is within the available nil rate band.

xiv) If you discover that too much IHT has been paid because of an error how long do you have to rectify the problem and obtain a tax refund?

Repayments of IHT come under section 241 of the Inheritance Tax Act of 1984, and the normal six years rule applies.

xv) I'd appreciate your advice on this scenario:

Each of my children is given £100,000 by me as an outright gift, but in each case the children lend the funds back to me on the basis that they can call for repayment at any time. This is all fully documented.

If I now survive for seven years would the Revenue consider these to be valid debts (assuming they were still outstanding)? And therefore would they have to be repaid out of my estate prior to the calculation of any Inheritance Tax on the remaining estate?

Also would it make any difference if the debts were interest bearing or interest free?

The gifts would fall out of your estate completely for IHT after 7 years.

If the loans are interest free, or indeed at less than full commercial rates, the Revenue will consider the gifts as 'with reservation' and they will include the gifts in your estate for IHT purposes.

You run this risk unless the loans are made fully at 'arms length' – and therefore on full commercial rates and terms.

xvi) My husband and I are considering moving to Gibraltar where we would become residents of Gibraltar. We are both British. We have property (which we will rent out) and assets in the UK but held in our individual names.

Could you please advise whether we would remain UK domiciled if we leave the UK and also, should one of us die while resident in Gibraltar, whether we will still be exempt from inheritance tax as we are spouses.

I would not say it is impossible to lose your domicile (in England and Wales, Scotland or Northern Ireland) if you retain assets here, but it does make things harder.

You have to show an intention to permanently give up your 'Britishness', which would be very difficult to show if property is retained here.

However, the longer you live abroad the easier it may be to show this as the asset changes from being one available for quick returns (if needed) into an investment.

Either way you remain domiciled in the UK for three years after your departure, whatever your intention. It is best seek advice so that you are clear on all the ramifications.

xvii) For IHT reasons I want to own my home in unequal shares with my brother as ‘tenants in common’.

Is it possible to draw up an equitable agreement as my home has a small mortgage (as he does not want become party to the legal mortgage)?

The equitable agreement gives my brother a share in my house for the cash he has given me.

Would this equitable agreement be recognised for IHT?

I assume the equitable agreement cannot be lodged with land registry due to my mortgage?

A Declaration of Trust can be drawn by which you record the share of the equity he has purchased from you, recording also that you are retaining the responsibility for the discharging of any mortgage. There are no IHT problems with any of this.

xviii) My father recently passed away and left £120,000 to my elderly mother. She would now like to give £40,000 to each of her two children and keep £40,000 for herself.

She owns a house worth over £285,000.

She is worried that if she gives us £40,000 each and then dies within seven years, IHT at 40 per cent will be charged on these gifts (minus the £3,000 allowance).

Is there a way to make these gifts to her children without the risk of IHT?

And would it be better to challenge the will, which is not yet at probate? My father wanted the money distributed in this way, but did not specify it in his will.

A Discounted Gift Trust would allow your mother to gift away the cash to you and your sibling through a Trust.

You would not be allowed to touch the gift until the inevitable happened to your mother, but your mother would be allowed to take an income for life from the gift she has made to you.

The result is that on starting the Trust and making the gift, a considerable portion (eg 35% for a healthy 80 year-old female) of the amount put into it would be immediately classed as outside the estate for Inheritance Tax purposes.

After seven years the whole amount is then outside the estate, and you have then avoided Inheritance Tax on the complete gift.

If, on the other hand, you wanted to undertake a deed of variation to your father’s will, it must be done within two years of his death.

xix) If I set up a Will for my wife and myself with a discretionary Trust clause to take effect on the first death and take advantage of the nil rate band of IHT, do we have to own our home as 'Tenants in Common' to ensure these Wills are effective?

And is there any disadvantage to being ‘Tenants in common'? Or can we remain as 'Joint Tenants'?

To get the maximum advantage of a Nil Rate Band Discretionary Trust Will the first of you or your wife to die must leave an estate valued to at least the Nil Rate Band level - £285,000.

If you each have that much each in addition to your house – then there’s no problem.

If not then your interest in the house may have to be used in whole or in part. If so you must sever the joint tenancy otherwise all of the house will automatically all belong to the surviving spouse.

There are no disadvantages to severing the tenancy.

A Nil Rate Band Discretionary Trust Will is a complex thing to get right and we are talking of a considerable potential IHT saving - up to £110,000.

It is well worth paying for a professional will writer to do this job for you.

xx) I understand the basis for setting up a Discounted Gift Trust but I am unsure of the basis for any income drawn from the scheme. Can you please advise on the Revenue’s view given that it is effectively capital which is being returned.

My father, a widower, has a considerable amount of cash, £500,000, and has little income requirement beyond his day-to-day nursing fees.

He had a stroke seven years ago but is stable and healthy. I understand his health could be underwritten, but the loading may be quite high and the discount small.

My question relates around the income: he receives an income from investments and will continue to until he passes away.

Any use of the Discounted Gift Trust would be to mitigate IHT only and not provide an income.

I am not sure how the Revenue would view this scenario. Does it require you to demonstrate an absolute need for income from the plan?

I think that you need to clarify the objectives.

If your father is looking simply to reduce the value of his estate, and does not need the income from all of his investments, then the logical course would be to gift the surplus assets and to hope to survive seven years.

On the other hand, if he does need an income from all his investments, then the discounted gift Trust is a very helpful way to gift capital AND to retain the right to an income, without it being considered either a gift with reservation of benefit, or being liable to the Pre-Owned Assets tax.

There is absolutely no need to show any need for the income. He could always gift it under the £3,000 per annum allowance.

An investment into a discounted gift Trust is still a potentially exempt transfer for IHT purposes, and he needs to live for a further seven years.

The discount simply recognises that since an income is being taken from the capital, the longer the donor lives the less of the capital is actually being gifted for IHT purposes. As

you point out, if your father's assessed longevity is less than the actuarial average, then the amount of the discount will be reduced.

Any post-death investigation by the Revenue into the Trust will only occur if your father dies within the seven year period, and they would then need to look to see if the discount was reasonable. You should therefore have the policy medically underwritten.

xxi) My father died recently and left an estate of a house in sole ownership (valued at £170,000) and £150,000 in cash. He left all of his estate to my mother.

My mother is financially well provided for and would like to re-distribute £275,000 from my father's estate, with a deed of variation, to me, my brother and my sister in the following proportions:

Myself - half of the house (value £85,000) and £6,666

My Brother - half the house (£85,000) and £6,666

My sister would receive money equivalent to £91,666.

My mother will continue to live in the house with my brother rent free, while sharing the other bills.

My sister and I do not live at this house and I will sell my half of the property to my brother within two months for market price (£85,000) - giving him full ownership of the property.

My Questions are:

a) Will my mother living rent-free in this house be classed as a consideration (possibly breaking one of the Inland Revenues conditions for a valid deed of variation)?

b) Could this also be seen as a reservation of benefit, even though it is not a gift but technically has come to us from my father's estate via a deed of variation?

This should be quite straightforward.

The deed of variation could simply rewrite your father's will to gift the house equally between your brother and you, with the balance of the nil rate band being split as you describe.

There is no reservation of benefit because the donor (your father) is dead and therefore clearly cannot benefit.

Your mother's rent free occupation cannot be for consideration as there isn't any. Your mother does not/ did not own the house.

However, if the deed of variation places the house into Trust for you and your brother, then your mother's occupation could amount to an 'interest in possession' - unless care is taken when wording the Trust and in subsequent actions by the Trustees.

In the circumstances, a straight gift may seem more appropriate, but if I were your mum's advisor I would be cautioning her about her future security in the house.

While I am sure you and your brother have your mother's best interests at heart, sometimes external factors (divorce, debt, bankruptcy, accident and death) can bring unforeseen consequences.

Your mother really needs to speak to a solicitor experienced in these matters, ideally a member of the Society of Trust and Estate Practitioners (see www.step.org for members near you).

xxii) I have my name on two properties, my prime residence, and a second one that I purchased 20 years ago jointly with my father as a Council 'Right to Buy' Home. My parents had lived there 25 years, but had no cash, so I purchased it for them, though both mine father's name are on the deeds.

Now in their late eighties they need to move to a smaller flat with a warden, so we are selling the property.

They have never paid rent to me since the purchase and have never contributed towards the mortgage cost.

They insist I take the proceeds of the property sale in return. According to what I've read, in 1988 a law was passed that says, providing they never paid any rent, there would be no inheritance tax on the sale of the property, or even Capital Gains Tax.

Are we correct that on the sale, there would be neither IHT or CGT to pay, even if the net profit is effectively £180,000?

I should add that we purchased the house for £12,500 in 1985, released equity to the tune of £100,000 in later years, and have an outstanding mortgage of £99,000, although a sale price will be £195,000 or so.

You are apparently referring to dependent relative relief and assuming you satisfy all the conditions, you will be exempted from Capital Gains Tax on the gain on sale of the property. As far as Inheritance Tax is concerned, the property is apparently yours and therefore the sale monies are yours. You will not receive any gift from your parents and therefore the question of IHT does not arise.

13 FINDING AN ACCOUNTANT/SOLICITOR/TAX ADVISOR

A good accountant and tax advisor will be able to manage your money affairs and reduce your IHT liabilities.

A solicitor can help set up a Trust and advise which may best suit your personal circumstances.

In many ways, they'll be using the same techniques we have described in this book.

An Independent Financial Advisor (IFA) is also a great source for practical help on many personal situations such as finding life assurance and insurance that will help cover your IHT liability.

IFAs can also help with pension planning and more general personal financial matters.

You will also be advised to find a Will writer (most probably through one of the other three sources of advice).

Depending on where you live in the country I can recommend which advisor will suit you best.

Once you've read and digested this section you will:

- Know what a tax advisor is and what typical qualifications one will have
- Be able to decide whether you should use a general tax advisor or a specialist
- Know how to find a good advisor/solicitor

13.1 Tax advisors and their qualifications

Perhaps the main reason I wrote this book was to clear up some of the confusion about IHT. This confusion is mainly caused because so many advisors are actually just trying to sell a product.

It is important to focus on what IHT is really all about – tax! And that focus should be from a professional without an interest in selling any specific product or scheme.

A tax advisor can be a member of the Chartered Institute of Taxation or the Association of Taxation Technicians.

They will have received formal training in taxation matters and can use the letters ATII or ATT after their name.

Tax advisors can also be qualified accountants who have had formal training.

They will be a member of one of the accounting bodies and will have the letters ACA, FCA, CA, ACCA or FCCA after their name.

However, anybody can become a tax advisor: there is no statutory authority that governs tax advice. You should always request information about a tax advisor's background and experience before instructing them to deal with your tax affairs.

13.2 Appropriate advisors

In this category we would include:

- Former tax inspectors
- People who have passed the Chartered Institute of Taxation or Association of Taxation Technicians examinations. These individuals can use the letters ATII, FTII or ATT after their name

When it comes to accountants, the Inland Revenue has recommended the use only of qualified accountants. This follows problems they have experienced with unqualified accountants.

There is no legislation preventing anyone calling themselves an accountant, unlike, for example, the legal profession.

Chartered Accountants have the highest level of examinations, have an external review body auditing their work known as Practice Assurance, and they must attend Continual Professional Training throughout their careers.

13.3 What a qualified accountant or tax advisor can do for you

An accountant or tax advisor will be able to prepare your tax return, calculate your liability and deal with any Inland Revenue inquiries.

Beyond that, however, they can also:

- Prepare accounts for probate issues
- Give tax-planning advice
- Give advice for specialist areas of taxation governed by complex legislation

13.4 Specialist or general advisors – who's better?

Sometimes more expensive advisors can work out cheaper in the long run. So, it's unwise to rule out a potential advisor on cost alone.

For instance, Inheritance Tax specialists may charge more than an average accountant. However, this specialist can often provide the answer faster than the non-specialist.

The difference between a specialist and a non-specialist is that the specialist tax advisor should be able to provide immediate answers, whereas the non-specialist may need to spend some hours researching the question (and the Inland Revenue documentation) before providing an answer.

13.5 What you can expect to pay

Here's an example of what you might be reasonably charged:

Specialist Advisor - £120 per hour

15 minutes to clarify issues with client

45 minutes to provide a written response

Total 1 hour, cost £120 + VAT

Non Specialist Advisor £100 per hour

15 minutes to clarify issues with client

1.5 hours to research topic

45 minutes to provide written response

Total 2.5 hours, cost £250 + VAT

So, the specialist - costing 20% more per hour, actually costs you less – in fact, 50% less. This is why it is so important to establish whether or not your advisor knows the topic in detail.

If you find that you are asking questions that your accountant needs to research - or worse still - needs to ask a specialist, then you are considerably increasing your costs.

Try to establish two things when you set out your working relationship:

- The area of specialist knowledge that your advisor can offer
- That your advisor will tell you before 'conducting research' or contracting with other advisors so that you can instead establish contact directly with appropriate experts.

Note: If your tax arrangements are simple and they are likely to remain static (i.e. you'll buy and hold just a few assets) then you may find that cheaper, more general tax advice is sufficient.

But having an advisor who can work with you on other projects and even assist your business friends in other areas can be of great benefit.

Having a free hour's consultation such as that offered by Cranleys (www.cranleys.co.uk) can be a way to test the water.

Always try and obtain a fixed fee for the work and then you will not receive any surprise bills or shocks later.

13.6 Finding the right advisor – why age matters!

Finding the right advisor is dependent on your ability to define the tax and accounting services that you require.

This sounds easier than it really is. That is because you are attempting to make a choice based on your prediction of your future requirements.

And, as we all know, the future rarely turns out as we expect!

For this reason, as well as finding someone with the right skills and specialist areas of knowledge, it is also very important to be able to establish a good working relationship.

A good working relationship is key to being able to solve those unknown future problems.

To build a lasting relationship, it is also often a good idea to look for an advisor who is of a similar age to you.

Yes, that's right, age does matter - let me explain why…

If you are cash rich at 25, then you'll very likely be looking for an older, more experienced advisor. But if you choose an advisor already 55, you'll find in 10 years (or possibly less) that one of your key advisors is about to retire.

Find someone closer to your age and as your IHT concerns grow and change, the advisor who knows you and your circumstances will be around to help. In other words, set up the relationship for the long term.

You'll also find that the interests of a 35 year-old advisor will be closer to those of the 25 year-old entrepreneur, i.e. they both want to develop and grow their careers and business.

Obviously, a 55 year-old accountant will be more focused on retirement and possible IHT issues. So, if these issues feature in your short to medium term goals, then you might be wise to look for someone a little older.

13.7 Finding a good tax advisor/solicitor/IFA in three easy steps

Step 1 Write down your estate-planning goals

Specifically, try to decide how you want to plan for the future – does this plan concern your business, your home, savings – or a combination?

If your business is very specialist and requires specific knowledge – such as a property developer (see our 'Property Tax Secrets' book for more information) - then you may need to seek specialist knowledge.

Step 2 Ask everyone you know for recommendations and create a short list of potential advisors

In particular, ask the following:

Who is in a similar situation to me?

Ask your solicitor. Solicitors and accountants tend to work very closely together and often pass work between them. If you have already found a good solicitor that you enjoy working with, then the chances are that your solicitor will be able to recommend a good accountant.

Remember that the solicitor will be keen to ensure that you find the right accountant (after all he'll want to keep your business).

In addition, a lawyer will be able to recommend accountants based on a professional experience.

Step 3 Ask these questions about your prospective advisor:

- Do the long-term goals of your advisor match your own?
- Are you of a similar age/aspiration?
- Does the professional knowledge of the prospective advisor match that of your investment/ business goals?
- Are you clear about your advisor's costs? (It is a good idea to start the relationship off on a charge per project basis - this allows you to stay in control of any potential costs).
- Are you clear about how the relationship will work if you require additional advice outside the scope of your agreement?

Key Tip

Sometimes a general advisor will charge less - or even waive the cost - for additional research, if they think the knowledge can be used to advise other clients.

After reading this section you will now know:

- What a tax advisor is and what typical qualifications one will have
- Whether you should use a general tax advisor or a specialist
- How to find a good advisor

14 MAKING YOUR IHT PAYMENT

Example 42

Craig dies in March 2005, leaving his wife Carmen with a total IHT liability of £3,500.

Carmen does not settle this amount within 12 months.

She will be fined up to £3,000!

The new Finance Act (2004) has made it easier for us all to settle IHT payments. Whereas you used to get six months, the new law means that you now get 12 months to pay before any penalties.

The new penalty laws have been brought in to bring IHT law more in line with similar laws for income and capital gains taxes.

14.1 If you miss the deadline or fail to pay IHT…

Whichever way you look at it, it makes sense to pay what you owe and to pay it on time.

Here's why…

- If you don't pay within 12 months of the due date – you can be fined up to £3,000
- If you fail to notify the Inland Revenue of a variation of a disposition within 12 months of it happening – you can be fined up to £3,000
- If you deliver an IHT account late - £100 (unless the amount concerned is less than £100 - or you have a great excuse for being late).

14.2 Property holders - Ten equal payments

For IHT payments resulting from land or buildings, you can chose to make ten equal, yearly payments.

This can make IHT payments much less of a burden; although bear in mind that interest will be charged on the payments.

Also, if the property or land in question is sold after you begin your yearly payments, the outstanding balance owed becomes payable immediately.

The interest rate for both instalments and other late payments is around 4%.

14.3 Your accounts

Your personal representatives – accountant or other – must deliver a set of accounts to the Inland Revenue in the event of your death.

Within these accounts, any tax relief or exemptions claimed must be identified. All the lifetime transfers made in the seven years prior to your death will need to be detailed – hence the reason why we advise you to keep as thorough a record as possible.

The accounts also need to summarise the total assets of the estate, the value at the time of your death and the amount of IHT that's now due.

It is essential that you keep a good record of all your assets and update it every year. Perhaps discuss this with your family as part of an annual tax planning review.

If the value of your estate falls below the NRB, then you are not usually expected to complete such a task.

15 Appendix 1- Institutions free from IHT

Why not give your assets to those who will ensure you pay no IHT!

Gifts to the following national organisations or bodies are exempt from IHT:

Art galleries or museums maintained by a local authority or UK university

These include all of the major museums such as the British Museum, The National Gallery, The National Museum of Scotland, The National Museum of Wales, The Ulster Museum, etc.

- Conservation or other charitable Trusts.
- Government
- Health Services Bodies
- Libraries
- Local authorities
- The National Trust and its UK equivalents.
- The Historic Churches Preservation Trust
- Universities

16 APPENDIX 2 - TEN TOP IHT MONEY SAVING TIPS

Here are ten things you should do so your loved ones can enjoy a better financial future…

Make a Will. Change a Will.

Yes, you can make a Will on a scrap of paper, or even buy a kit from a high street store. But as a Will is one of the most important documents you'll ever create, it's much better to get a professional to help you do it properly.

A Will lets you list your possessions and claim your NRB without fuss. And remember, when your circumstances change, update your Will!

Know your NRB. Keep a record of big transfers.

Keep in touch with the latest NRB rate. It will increase from £285,000. Keep a rough record of the value of your estate above the NRB. That way, you can always make planning decisions – for example, when to give away part of your estate and how much to give.

This also means keeping a record of larger transfers made over several years.

Use your one-off and personal exemptions.

When you're calculating your lifetime transfers, remember to discount your personal exemptions and other one-offs such as wedding gifts.

Insure yourself.

If you have a big estate, take out an insurance policy to cover some of the excess. Get the cheapest policy you can. Make it for a short term. Review it every few years if your circumstances change.

Put it in Trust.

A Will Trust is a good option for virtually all cases. But there are many other Trusts that also have great tax benefits – paying for your kids through school, for example.

Pass on the home before you go.

We've outlined several strategies – Trust of debt, borrowing against capital – that cut out the IHT liability on your home altogether. The home is often the biggest IHT liability for all of us – and you can't take it with you!

Put all your assets in the company.

If you own or are a majority stakeholder in a business, put all of your assets within the company. Otherwise, any plants or other unrelated property will only qualify for 50% IHT.

A number of you reading this will have property portfolios. Did you know that land and property used for investment has no relief whatsoever?

So what you must do is switch into some commercial property, set up a trading company that uses this property and get someone to manage it. It is after all meant to be for your retirement.

Waive your shares.

If you want to pass on a business interest, divert your shares to someone else in order to waive the income tax and IHT implications.

Plan offshore.

If you have links abroad and are not a UK domicile, you could really benefit from setting up a Trust offshore. You may not suffer the same penalties and you get tax deferrals.

Rescue poor planning with a variance.

As a last resort, use a deed of variance to pass on property or possessions. Just make sure you do it within two years. If you don't have this power directly, remember you may be able to demand a variation through the courts.

17 Appendix 3 – What you can do today to cut IHT

- Make it easy for your loved ones to understand the value of your estate and your liabilities. It is they, after all, who will be faced with grief and financial worries if you die.
- Use the software provided with this book to review your total assets (less any liabilities) and see what you are worth.
- Look into the cost of an insurance premium. It may be cheaper than you think and will cover your liability completely.
- Make a Will. And make sure you use your NRB. And your spouse's!
- Think about which one of the home planning strategies you've read about will save you money. Now write it down and discuss it with your spouse – don't put it off!
- Do the same for your business. Have a one-page summary of all your business assets to hand. Which of the business IHT saving strategies will suit your business best?
- Start keeping a record of all the money you've given away outside of your personal exemptions. Any of us can die at any time, so a record of big financial transfers in an easy to find place is essential.
- Think about who's best to pay the tax bill when you're making a lifetime transfer. As we've seen, it doesn't always make sense for you to foot the bill!
- Take professional advice on your situation. Do take action today. Don't leave it until tomorrow…

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