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Inheritance Tax

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Inheritance Tax

Inheritance Tax (IHT) is sometimes referred to as the "avoidable tax" as it usually impinges upon assets retained by an individual at the date of death. Consequently, in simple terms, the less one "leaves behind" the less IHT would be payable. Unfortunately, life and death are not so "simple" in that, depending upon one's life span and lifestyle, an individual may accumulate more than a modest amount from which Her Majesty's Treasury will not be slow to demand its share.

Ideally, an individual should review his or her financial position at least once every five years, assess the need to retain assets for future requirements, and consider whether or to what extent assets can be given to children, grandchildren and other parties including charity, and thereby mitigate the potential impact of IHT.

Whilst there are exemptions and reliefs from IHT, one must be mindful of various pitfalls which need to be avoided in order to secure them so as to reduce the potential amount which the Government might otherwise extract from one's assets.

This guide has been produced to illustrate the basic features of IHT, coupled with possibilities for its mitigation, and to prompt the reader into taking action which may result in a greater amount being available for the "next generation" than would otherwise be the case.

We would be pleased to discuss with you any matters concerning mitigation of IHT on your Estate – please contact a Partner in the Firm to arrange a meeting.

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1. Introduction

1.1 Broadly speaking, Inheritance Tax (IHT) is a form of "wealth tax" which is levied on the value of assets which pass out of an individual's ownership, during lifetime and on death.

1.2 The above is an oversimplification as there are many circumstances in which an individual may dispose of assets and not generate any liability to IHT: for example, sales of assets in the ordinary course of business or disposals of investments for full "market value".

1.3 In practice, a liability to IHT arises where there is a gift of an asset (e.g. cash, shares or property), during an individual's lifetime and upon the value of the "Estate" on death. The term "Estate" refers to the net value of an individual's assets less liabilities.

Where death occurs on or after 17 July 2013, a liability will only be deductible for IHT purposes if it is actually discharged (paid) from the Estate on or after death, unless there is a real commercial reason for its not being discharged and that obtaining a tax advantage is not the main purpose for its remaining un-discharged.

1.4 IHT is chargeable in respect of "worldwide" sited assets of a UK-Domiciled individual but only on UK-sited assets of a non-UK-Domiciled individual.

For IHT purposes, an individual may be "deemed" UK-Domiciled, (even though being regarded as Domiciled abroad under general tax law), where:-

The individual was domiciled (under general law) in the UK at any time during the three fiscal years immediately preceding the date of gift or death.

Or

The individual was resident in the UK in not less than seventeen of the twenty (fiscal) years ending with the year in which the gift or death occurs.

1.5 Foreign-domiciled individuals coming to, or having recently arrived in, the UK should take steps to protect their foreign-sited assets from the impact of IHT (and other UK Taxes). Detailed comments on the above are outside the scope of this booklet but relevant action would usually include the "ring-fencing" of ownership of those assets within a foreign (non-UK) Trust.

1.6 Currently, the first £325,000 of the total amount chargeable to IHT is at "Nil" Rate which is referred to as the "Nil Rate Band" (NRB). Any excess over the NRB is charged at 40% on death or 20% for lifetime transfers.

1.7 IHT is chargeable on the aggregate amount of an individual's Estate together with the value of any gifts made within seven years prior to death.

There is a form of "taper" relief where gifts are made more than 3 years prior to death with the result that:

Gift made prior to death	Percentage of the tax payable on death
0-3 years	100
3-4 years	80
4-5 years	60
5-6 years	40
6-7 years	20

2. Exemptions

2.1 There is a number of exemptions from the charge to IHT, the most common of these being:

Transfers of assets between spouses either during lifetime or on death, provided that both spouses are domiciled in the UK.

Outright gifts made to other individuals at least seven years before the death of the donor.

Annual gifts made by an individual up to an aggregate of £3,000.

Where the annual exemption of £3,000 is not utilised in any one year, it can be "carried forward" to the subsequent year so that an individual could then make gifts up to an aggregate amount of £6,000: the annual exemption cannot be carried forward more than one year.

Annual gifts aggregating no more than £250 to any one individual.

Gifts in consideration of marriage made by parents or other parties. These are subject to certain limits: £5,000 by a parent of either party to the marriage; £2,500 by one party to the marriage to the other; £1,000 in any other case.

Gifts to charities or for "national purposes".

2.2 Prior to 6 April 2013, the inter-spousal exemption was limited to an amount of £55,000 where the recipient spouse was non-UK-Domiciled. Transfers from a non-UK-Domiciled spouse to a UK-domiciled spouse were always subject to the full inter-spousal exemption.

2.3 From 6 April 2013, new provisions apply to lifetime transfers by, or transfers on death of, a UK-Domiciled spouse ("D"), in favour of a non-UK-Domiciled spouse ("NDS").

First, the exemption limit for gifts from D to NDS is increased from £55,000 to £325,000 which is the present NRB for IHT purposes and will be adjusted in line with any future increases in the NRB.

In addition, NDS will be entitled to make an election to be treated as UK-Domiciled (for IHT purposes) with the result that the inter-spousal exemption would not be restricted.

There are two types of election being a "lifetime" election and a "death" election. The "lifetime" election is one that is made whilst D is alive and the "death" election is made after D has died.

In relation to each type of election, either of the following conditions must be met:

At any time on or after 6 April 2013 and during the period of seven years ending with the date on which the election is made, D was domiciled in the UK.

D dies and at any time on or after 6 April 2013 and within seven years preceding death was both UK-Domiciled and the spouse of NDS.

An election will be effective from the date specified therein which must be on or after 6 April 2013 and within the seven year period ending with:–

The date on which the election is made (if a "lifetime" election); or

The date of D's death (if a "death" election).

A "death" election must be made within two years of D's death.

Great care must be taken in deciding whether or not to make the election as it would result in overseas (non-UK) sited assets of NDS being brought within the IHT "net". In the majority of instances, that decision will be governed by the relative values of assets held by NDS outside of the UK and the assets received from D on death or within seven years prior thereto.

3. Normal Expenditure out of Income

3.1 An IHT exemption which is often overlooked relates to what is known as "normal expenditure out of income".

3.2 In order to qualify for this exemption there must be an habitual pattern of gifts coupled with the requirement that making the gifts does not reduce the donor's capital or standard of living: note that the gifts need not be identical in amount. Consequently, a wealthy individual could make significant gifts to children (and grandchildren) which do not become chargeable to IHT even if the individual dies within seven years of making such gifts. One must be able to demonstrate the habitual pattern of gifts coupled with the financial consequences as indicated above.

3.3 A claim for this exemption requires completion of a detailed schedule (to the IHT Return on death) indicating source and application of income (and other funds) over a seven-year period.

4. Gifts to Charities

4.1 "Charity" means "any body of persons or trust established for charitable purposes only".

Consequently, when making any lifetime charitable donation or including a charitable bequest in a Will, it would be sensible to ensure that the recipient charity is registered with the Charity Commission or equivalent body in another EU country.

4.2 Lifetime gifts to charity or charitable bequests in Wills are totally exempt from IHT. Bearing in mind that IHT on death is chargeable at 40% (above the NRB), a charitable bequest of £10,000 would reduce the amount available to other beneficiaries by only £6,000.

4.3 With effect from April 2012, where an individual leaves at least 10% of his or her Net Estate (after deducting the NRB) to charity, IHT is chargeable at 36% instead of 40%.

At first sight, the above reduction in the rate of IHT may not seem significant but, as will be shown in the following example, that is not the case.

	Without Charitable Bequest (£)	With Charitable Bequest (£)
Value of Estate	1,000,000	1,000,000
NRB	(325,000)	(325,000)
Net Estate	675,000	675,000
Charitable Bequest	Nil	(68,000)
Amount chargeable to IHT	675,000	607,000
IHT at 40% - 36%	270,000	219,000
Amounts available for:		
Charity	Nil	68,000
Other Beneficiaries	730,000	713,000

Consequently the charitable bequest of £68,000 reduces the amount available to other beneficiaries by only £17,000 – the difference of £51,000 is effectively contributed by HM Treasury!

The above example ignores any bequest to a surviving spouse (which would be exempt for IHT) or the additional NRB available to a surviving spouse where none (or only some) was utilised on the death of the first spouse to die (which is described in detail at paragraph 7 below).

4.4 Whereas one should not let the tax-saving dictate familial considerations, it may be worthwhile making amendments to existing Wills to incorporate an appropriate charitable bequest. In circumstances where death has already occurred, and subject to agreement by all of the beneficiaries, the charitable bequest could be made by a Deed of Variation which, to be effective for IHT purposes, must be executed within two years of the date of death. Needless to say, matters concerning Wills should be dealt with by a competent solicitor.

5. Potentially Exempt Transfers

5.1 Outright gifts to individuals are referred to as "Potentially Exempt Transfers", colloquially known as "PETs". Provided that the donor survives for at least seven years after making a PET, the value thereof is not chargeable to IHT.

5.2 Gifts made within three years prior to death are fully chargeable to IHT: those made more than three years (but less than seven years) before death attract progressively lower rates of IHT (as indicated at paragraph 1.7 above).

5.3 Gifts other than those made to individuals constitute what are known as "Chargeable Transfers" which are immediately chargeable to IHT: the most common example of these are transfers into Trusts (on which further comment is made at paragraph 12 below).

6. Wills

6.1 Before considering other methods of mitigating the impact of IHT, one needs to ensure that a properly drafted and executed Will has been made by an individual.

6.2 Surprising as it may seem, the majority of individuals in the UK have not prepared Wills: either because they do not wish to recognise their ultimate demise or because they feel that "matters will be dealt with by the family" after death.

6.3 Without a Will, an individual's Estate will be administered (distributed) in accordance with what are known as "Intestacy Rules", as follows:

Where the individual is married and has children, the surviving spouse receives the first £250,000 and personal possessions together with what is known as a "life interest" in half of the residue of the Estate.

The other half of the residue passes to children in equal proportions.

The "life interest" results in the surviving spouse having the benefit of the "income" from the one-half of the residue, the capital thereof ultimately passing to the children (in equal proportions) on death of the surviving spouse.

Where there are no surviving children the legacy for the spouse is £450,000 plus a life interest in half the residue; the other half of the residue passes to other blood relatives of the deceased (in a prescribed order).

6.4 For example, a married man dies leaving an Estate of £700,000, but without having made a Will (his widow having

little or no assets in her own right). Instead of the widow receiving the whole of her late husband's Estate (which she may need), she receives £250,000 and the income from £225,000 (life interest): children receive £225,000.

The above does not result in any IHT liability arising as the amount receivable by the children is less than £325,000.

6.5 Consider however, the position if the husband died leaving an Estate of, say, £1million. The widow would receive £250,000 plus income from £375,000 (the life interest) and the children would then receive the remaining £375,000.

The £375,000 receivable by the children would be chargeable to IHT: £325,000 would be covered by the NRB; the balance of £50,000 would result in a liability of £20,000.

If a properly drawn Will had been prepared, it would have been possible for the husband to ensure that his widow enjoyed the benefit of the majority, if not all, of his assets and no IHT would have been payable on his death.

6.6 It is important to note that bequests contained in a Will (or, in the absence thereof, the legacies on Intestacy) may be disclaimed or varied after the death. That would be achieved by the beneficiaries entering into a "Deed of Variation" which must be effected within two years of the date of death.

The Deed of Variation must be signed by all parties who would have benefited under the terms of the Will (or intestacy legacies) and must not be made for any other consideration in money or money's worth.

Provided that all relevant conditions are fulfilled, a Deed of Variation is treated for IHT purposes as if it had been made by the deceased and not by the persons entering into it.

In effect, therefore, it is possible to revise the terms of a Will or intestacy legacies (within two years of death), so as to provide a more appropriate distribution of an Estate both for IHT planning and familial purposes.

6.7 Consequently, in the example at paragraph 6.5 above, the IHT liability of £20,000 could be avoided by the widow and all of the children entering into a Deed of Variation whereby the children disclaim (at least) £50,000 of their intestacy legacy in favour of their mother.

6.8 Generally, where assets are owned in "joint names", the deceased's share automatically passes to the other owner(s) "by survivorship" and is not affected by a Will nor subject to the intestacy legacies.

6.9 The administration of an Estate is carried out by Executors who are nominated in the Will. Their legal ability to deal with the assets of the Estate is evidenced by what is known as the "Grant of Probate" which has to be obtained on formal application to the Probate Office.

Where an individual dies intestate, his Estate is administered by individuals referred to as "Administrators" who would normally be the persons entitled to benefit from the Estate under the intestacy rules e.g. surviving spouse and children. They obtain what is known as "Letters of Administration", the application process being similar to that in relation to Probate.

In this booklet the terms "Executors" and "Probate" are used to encompass "Administrators" and "Letters of Administration" respectively.

6.10 Apart from IHT-planning, a valid Will is necessary to reflect the wishes of the individual with regard to the identity of the persons who are to benefit from the Estate coupled with the amount and nature of assets bequeathed. Social trends over the past few decades result in a variety of familial and other relationships such as: second (and subsequent) marriages; children from former marriages; unmarried partners. Unless appropriate provisions are contained in a Will, some of the above persons may not benefit. In addition to distribution of assets, a Will can indicate the persons who are to act as legal guardians for young children.

It is important to note in these respects that changes in one's legal status, such as marriage or divorce, would invalidate an existing Will.

All of the above should therefore be discussed with a solicitor competent in dealing with such matters and an appropriately drafted Will then prepared.

7. Married Couples

7.1 A husband and wife are separately chargeable to IHT so that each of them has the opportunity of utilising the exemptions referred to at paragraph 2 above and, more importantly, each has the benefit of the NRB. Currently, a married couple has an aggregate amount of £650,000 to cover the value of their combined Estates (and any gifts made within seven years of their respective deaths), before IHT becomes payable.

7.2 The Finance Act 2008 included a major change in the IHT regime so far as concerns the utilisation of the NRB by married couples. Prior to that Act, it was important to ensure that each spouse took advantage of the NRB in relation to his or her Estate.

For example, a husband and wife each had assets of £500,000 and "mirror" Wills leaving the whole of their respective Estates to the surviving spouse. Assuming that the husband were the first spouse to die, the whole of his Estate passed to his widow as a result of which no IHT would have been payable on his death and the NRB would not have been used.

Assuming no change in value of assets or the NRB, on the death of the widow there would be an Estate of £1million, of which £325,000 would be absorbed by the NRB leaving £675,000 chargeable to IHT (at 40%) and resulting in a liability of £270,000.

7.3 In order to obviate the above problem, it was necessary for the respective Wills of each spouse to contain a bequest to what is colloquially referred to as a "Nil Rate Band Discretionary Trust" so that assets with a value equivalent to the NRB would not be distributed to the surviving spouse and, therefore, not form part of his or her Estate on subsequent death.

In simple terms, the "Discretionary Trust" referred to above is a mechanism whereby assets equal to the NRB could benefit any one of a number of persons including: the surviving spouse; children; grandchildren; or charities. In practice, the Trustees could decide to lend Trust assets to the surviving spouse so that he or she would benefit therefrom without their value increasing his or her Estate.

7.4 With effect from 10 October 2007, on the death of a surviving spouse, his or her Estate obtains the benefit of the proportion of the NRB which was not utilised on the earlier death of the other spouse.

Using the circumstances described at paragraph 7.2 above, on the death of the husband no IHT would be payable nor would his NRB have been utilised. On the subsequent death of the widow, (after 10 October 2007 and assuming no change in value of assets or the NRB), there would be an aggregate NRB of £650,000 to be set against her Estate of £1million, leaving £350,000 chargeable to IHT (at 40%) and resulting in a liability of £140,000. Thus, the change in legislation results in a reduction in the overall IHT liability of £130,000 (without the need for the Discretionary Trust).

7.5 The current legislation applies on the death of a surviving spouse notwithstanding the fact that the death of the former spouse may have occurred before 10 October 2007.

7.6 The proportion of the unutilised NRB when the first spouse dies will be applied to the Estate of the surviving spouse at the level of NRB then prevailing.

For example, a husband died in June 2000 and utilised only one-half of the NRB (which was then £234,000): on the subsequent death of his widow in, say, 2013 when the NRB is £325,000, her Estate would benefit from an aggregate NRB of £487,500; being £325,000 plus £162,500.

7.7 As a result of the above, it may be appropriate for married couples to reconsider existing Wills containing a "Nil Rate Band Discretionary Trust". Although that would have the effect of obtaining the benefit of the NRB on the death of each spouse, it would only take account of the NRB subsisting at the respective dates of death: if several years were to elapse before the death of the surviving spouse and the NRB were to be increased, the aggregate amount of NRB referable to both deaths could be less than that which would have been the case if all of the Estate were bequeathed to the surviving spouse. Despite former governmental pronouncements as regards potential increases in NRB, it has remained unchanged for five years and is likely to remain at £325,000 for the next five years.

7.8 There may however, be familial or financial reasons for including a "Nil Rate Band Discretionary Trust" within the Wills of a married couple. Executors would then have the opportunity of appropriating (transferring) certain assets into that Trust where such are considered to have potential for capital growth which would then fall outside of the Estate of the surviving spouse. Another reason is to limit the value of assets of a surviving spouse so as to preserve entitlement to social security or similar benefits.

8. Gifts with Reservation of Benefit

8.1 At this point, it is pertinent to mention the concept of "Gifts with Reservation of Benefit" (referred to as "GROB"). Put simply, the gift of an asset coupled with its continued enjoyment by the donor does not avoid IHT: fundamentally, the donor is deemed to retain the ownership of the asset for IHT purposes.

8.2 For example, there would be no IHT saving if an individual made a gift of his or her home to children and retained the right to live in it "rent-free". If the individual were to pay a full "market rent" to the children, there would not be a GROB. However, the children would be subject to Income Tax on the rental income and, on ultimate sale of the house, would be subject to Capital Gains Tax (CGT) on the difference between the sale proceeds and the value of the house at the date of the gift.

8.3 Opportunities may, however, exist for married couples to pass to adult children the value of assets without any IHT liability arising and retain the benefit of the income from those assets without such being regarded as a GROB.

For example, Mr & Mrs B each hold investments in excess of £500,000 including shares listed on the London Stock Exchange. They wish to pass shares with a value of say, £400,000 to their two adult children without crystallising a CGT liability and retain the benefit of the income from those shares.

Mr B sells shares with a value of £400,000 to Mrs B, leaving the consideration outstanding as a debt ("IOU") which is evidenced in writing.

Mr B subsequently makes a gift of the debt ("IOU") to the two adult children as a result of which:

Mrs B has the ownership of, and income from, the shares.

Mr B has made a "PET" of £400,000 and provided that he survives for seven years after making that gift, no IHT would be payable.

There is no "Reservation of Benefit" as between Mr & Mrs B nor in respect of the gift made by Mr B to the children.

There is no liability to CGT on the disposal of the shares by Mr B to Mrs B as transfers between spouses are "exempt" for CGT purposes.

On the death of Mrs B, the shares would form part of her Estate but the liability of £400,000 due to the children would be deducted, provided that such liability is actually paid by the Executors of Mrs B's Estate.

Consequently, there would be an IHT-saving of £160,000 (being 40% of £400,000).

8.4 The above example assumes that Mr B pre-deceases Mrs B: she would continue to enjoy the income from the shares, and the debt due by her would be satisfied from her Estate.

Were Mrs B to pre-decease Mr B, the debt of £400,000 would need to be paid from the Estate of Mrs B and, as a result, Mr B would not be able to enjoy the income on assets of that value.

Consequently, the above type of arrangement should only be contemplated if Mr & Mrs B are satisfied that, in the appropriate circumstances, Mr B could maintain his lifestyle without recourse to the income from the relevant shares or other assets.

8.5 Careful drafting of the document evidencing the debt is necessary and it is recommended that expert advice be obtained, including an Opinion by Tax Counsel.

8.6 The above and other arrangements for mitigating IHT must be considered in light of the new "General Anti-Abuse Rule" (GAAR) which became effective in July 2013. Briefly, that is intended to nullify the taxation effect of any transactions the main purpose of which is seen to be of a "tax avoidance" nature.

9. Discounted Gift Trust

9.1 There are certain financial "products" which may be of interest to individuals with substantial liquid funds where the individual is prepared to invest a "lump sum" and retain the right to a modest return – usually 5% per annum of the amount invested. One such product is known as the "Discounted Gift Trust" (DGT) which has been in existence for many years, is well known to HM Revenue & Customs, and appears to be effective in terms of IHT mitigation.

9.2 The arrangements usually involve the individual purchasing a single premium investment bond which is transferred into a trust for the benefit of family members subject to the individual retaining the right to regular capital repayments. As a result of the above, the value of the transfer ("gift") is "discounted" by reference to the age and life-expectancy of the individual: the younger the individual, the greater is the discount. Generally speaking, a DGT is only likely to be of advantage to individuals over 60 and less than 90 years of age.

9.3 For IHT purposes, the quantum of the gift is the discounted value so that, in effect, the "discount" itself results in an immediate IHT saving even if the individual were to die within three years of making that gift. As the transfer into a trust would be a chargeable transfer for IHT purposes, it should be less than the NRB so as to avoid any immediate IHT liability.

9.4 Provided that the individual survives for 7 years after making the gift there will be nothing to include in the Estate in this respect. Notwithstanding the right to receive those payments, the arrangements are structured in such a manner as to avoid the "GROB" legislation.

The above will, however, need to be considered in context of the GAAR.

9.5 Most DGTs are marketed by insurance companies. It is therefore most important to obtain advice from an independent financial advisor as regards the underlying investments within the bond and the overall effects of the arrangements.

10. Private Residence

10.1 In most circumstances, the major asset forming part of an individual's Estate is the private residence.

Over the years, a number of "schemes" or techniques have attempted to extract the value of a private residence from individuals' Estates. Suffice it to say, the Government has introduced a raft of anti-avoidance measures to counteract them.

10.2 There should, however, be considered the basis of joint ownership of the private residence by a married couple.

Most married couples own their home as "joint tenants", which means that each spouse has a one-half share in the whole of the house and, on the death of a spouse, his or her share automatically passes to the other spouse "by survivorship".

If, however, the house is owned as "tenants in common", each spouse has an absolute interest in one-half of the house and is able to direct in their Will as to where that interest passes: it does not automatically pass to the surviving spouse.

10.3 For the above purposes, it would be sensible to request a solicitor to review the Title Deeds of a jointly owned house (or any other property) and, if appropriate, arrange for such to be held as "tenants in common": the documentation is simple (literally, no more than one page!) and should be registered at the Land Registry.

10.4 Having severed the "joint tenancy" (and established a "tenancy in common"), the Will of each spouse could contain a specific bequest of his (or her) share in the house to the Trustees of a Discretionary Trust who would have power to sell that one-half share in the house or to allow a beneficiary (including the surviving spouse) to occupy it on a "rent-free" basis. It should be noted that the Trustees could not sell that one-half share in the house without the consent and cooperation of the surviving spouse who has ownership of the other half-share therein.

10.5 In the above circumstances a widow (or widower) could remain in occupation of the house without the half share of the former husband (or wife) being regarded as a "GROB" as that share is not owned by the widow. Furthermore, if the house is sold when the widow ceases to occupy it, the Trustees (of the Discretionary Trust) should not suffer CGT as they should be entitled to the exemption for "Principal Private Residence" by reference to the widow's occupation as a beneficiary of the Trust.

11. Business Property Relief

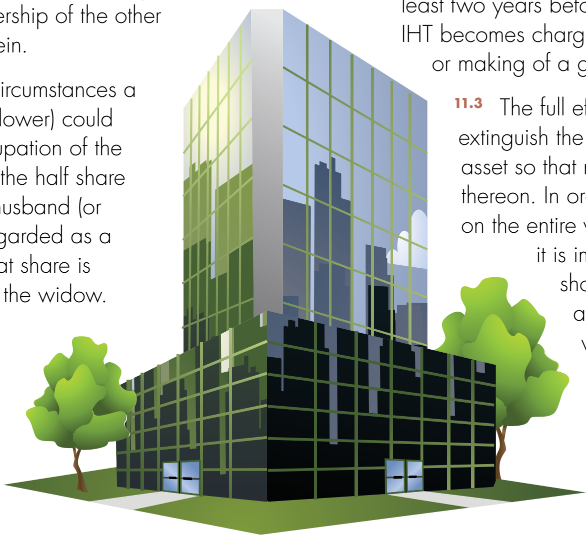
11.1 Apart from making lifetime gifts (and ensuring survival for at least seven years) and suitably drafting Wills, there should not be overlooked the possibility of acquiring assets which, by their nature, qualify for relief from IHT.

11.2 Interests in sole trades, partnerships and shares in private companies which undertake genuine "business" activities should qualify for what is known as "Business Property Relief" (BPR) provided that:

The "business" does not consist wholly or mainly of dealing in stocks or shares, land or buildings, nor the making of investments; and

the interest in the business is held for at least two years before the date on which IHT becomes chargeable (i.e. on death or making of a gift).

11.3 The full effect of BPR is to extinguish the value of the relevant asset so that no IHT is payable thereon. In order to obtain BPR on the entire value of "a business" it is important that there should not be any assets of significant value which have a "non business" use, otherwise the relief will be restricted.



11.4 Shares quoted on the Alternative Investment Market (AIM) would qualify for BPR, as would interests in forestry land provided that such is used for a commercial activity, usually involving the felling and sale of timber. Property development activities (e.g. house building) would also qualify for BPR purposes.

11.5 Whereas, there could be significant IHT-savings by judicious investment along the above lines, one should not allow the "tax tail to wag the commercial dog". Consequently, consideration of any of the above types of investment must take account of all relevant commercial factors and risks and the decision should be based primarily thereon and not on the potential IHT-saving.

11.6 Until April 2013 one could take advantage of an IHT computational technique which results in the value of an asset being reduced by the amount of any liability secured thereon.

For example, an individual had an Estate aggregating £2million of which £1million was represented by freehold property not qualifying for BPR: ultimately, the value of that property would be chargeable to IHT at 40% (£400,000).

The individual obtained a Bank Loan of £600,000 secured by a legal charge over the property.

From the proceeds of the Bank Loan, the individual invested £200,000 in shares in a residential construction company and £400,000 in a portfolio of AIM-listed securities.

Assuming no change in the above values and survival for at least two years, on the death of the individual the value of the shares in the construction company and AIM-listed securities would be subject to BPR which extinguishes their value chargeable to IHT. However the value of the property (£1million) would be reduced by the amount of the Bank Loan of £600,000, leaving £400,000 chargeable to IHT – i.e. £160,000.

By arranging matters in the above manner, there would be an IHT saving of £240,000.

11.7 The Government became concerned with the increasing use of the above and similar types of arrangements some of which involved complex schemes and substantial amounts. Consequently, legislation was introduced in the Finance Act 2013 which affects the calculation of IHT in respect of any death occurring after 16 July 2013.

The legislation restricts the deduction (for IHT purposes) of liabilities which are secured on assets such as a private residence or investment property (the "First Asset") but are attributable to financing the acquisition of other assets such as those qualifying for BPR (the "Second Asset"). In those circumstances, the amount of the liability will reduce, as far as possible, the value of the Second Asset and not the First Asset.

The restriction only applies to liabilities incurred after 5 April 2013. Accordingly, liabilities incurred prior to that date should be afforded the pre-existing treatment as described in paragraph 11.6 above.

If the circumstances described at paragraph 11.6 above, had occurred in August 2013 and there were no changes in the amount of the liability or the value of the investments on the death of the individual in, say, December 2015, the liability would be deducted from the assets qualifying for BPR (£600,000) which would be reduced to "Nil" and the value of the freehold property (£1million) would remain unaffected and thereby chargeable in full to IHT.

11.8 There are many instances where individuals owning shares in their family "trading companies" have made significant Loans to those companies. Whereas the value of the shares would qualify for BPR, the amount of the Loans would not.

Unless the individual is likely to require repayment of the Loans in the short-term, it may be advisable for the Loans to be converted into Ordinary Shares which, subject to their being held for the two year qualifying period, would then attract the benefit of BPR.

If repayment is required, the company could take the necessary steps to reduce capital and repay a portion of the shares, thereby providing the individual with the required funds.

Whereas the above type of arrangement is relatively simple, advice must be obtained from corporate lawyers as regards the fiscal and commercial effects of converting debt into equity and subsequently "Reducing Capital".

12. Trusts

12.1 A detailed commentary on Trusts is outside the scope of this booklet but it would be remiss not to mention their use in IHT planning.

12.2 A Trust arises when assets (cash, shares or property) are transferred by an individual (known as "the Settlor") to one or more persons (the Trustees) with instructions that the assets are to be held for the benefit of other individuals (the Beneficiaries). A Trust may be established during an individual's lifetime, in which case it is evidenced by a formal Trust Deed (and referred to as a "Settlement"): as indicated earlier, a Trust can be constituted by Will (and is referred to as a "Will Trust").

12.3 An individual may consider divesting himself of certain assets and place those in a Trust for the benefit of, say, children and grandchildren. Lifetime transfers of assets into a Trust are immediately chargeable to IHT. Consequently, if the value of the transfer is more than the NRB, IHT is chargeable on the excess at the "lifetime" rate of 20%: if the individual (Settlor) dies within seven years of making the transfer, additional IHT becomes payable. If the individual survives for seven years after making the transfer into Trust, no additional IHT becomes payable.

12.4 The individual should not make any other "Chargeable Transfer" (the second transfer) within seven years of the initial transfer into Trust as the value of that second transfer would be aggregated with the initial transfer and if the total exceeds the NRB at the date of the second transfer, IHT would be payable on the excess over that NRB.

12.5 A married couple could, in effect, transfer assets into Trusts (created by each of them) to an aggregate value of £650,000 which, subject to the seven year survival period, could escape IHT on their respective Estates.

In theory, the above procedure could be repeated, say, eight years later and, again, provided the individual survives for a further period of seven years, no IHT becomes payable on the assets transferred into Trust.

12.6 To be effective for IHT-mitigation and Income Tax purposes the Settlor and spouse may not benefit in any manner whatsoever from the Trust's assets and income.

12.7 A Trust suffers what is known as a "Periodic Charge" to IHT on each successive Ten-Year Anniversary of its establishment. Broadly speaking, the "Periodic Charge" is equal to 6% of the value of the "Trust Fund" (that is the assets less the liabilities) in excess of the NRB on each Ten Year Anniversary.

There are also "Exit Charges" which are applied to the value of assets which leave the Trust and are calculated at the rate of IHT payable on the previous Ten Year Anniversary (or on establishment of the Trust itself) and then pro-rated to the period between the date of that Anniversary (or establishment of the Trust) and the date upon which the assets leave the Trust. For the sake of completeness, "Exit Charges" do not apply to distribution of "Income" from a Trust to beneficiaries.

12.8 Transfer of assets (other than cash) into Trust are regarded as "disposals" for CGT purposes which are deemed to take place at "open market value", irrespective of the fact that the transfer may be by way of gift. However, there are provisions in the tax legislation whereby the inherent Capital Gain can be "held-over" and the Trustees are then deemed to have acquired the asset at the original cost in the hands of the donor.

12.9 As will be appreciated, utilisation of Trusts is a complex subject which requires detailed consideration of legal and fiscal issues and, consequently, should not be embarked upon without obtaining appropriate professional advice.

13. Payment of IHT and use of Life Assurance Policies

13.1 IHT is payable six months after the date of a gift chargeable to IHT which, in the case of an Estate, would be six months after the date of death.

The above can prove problematic particularly if the majority of an Estate is represented by assets which are not easily realisable – e.g. property or shareholdings in a private company.

Where an Estate includes property or shares in unquoted companies with a value of at least £20,000 and the IHT referable to those assets is at least 20% of the total IHT on the Estate, an application can be made to HM Revenue & Customs for the tax on these assets to be paid by 10 equal annual instalments, the first of which is due six months after the date of death. Interest is charged on the instalments from the above date to the respective date of payment.

If any of the above assets are sold, any related tax then outstanding must be paid in full.

13.2 A problem facing Executors is that in order to obtain Probate they must first submit to HM Revenue & Customs the Inheritance Tax Account (IHT Return) and pay any IHT which is due. Where "hardship" can be demonstrated, HM Revenue & Customs are known to enter into arrangements whereby the Grant of Probate can be obtained prior to payment of the IHT. Subject to that, Executors may need to obtain temporary funding to settle the IHT.

In addition to the above logistical problems, it may transpire that the period immediately following death of an individual may not be the most opportune time for disposal of assets where, for example, there is a downturn in the economic climate which may result in assets not realising their full potential.

13.3 Consequently, an individual could make financial provision towards payment of IHT by effecting a Life Assurance Policy (LAP) or policies anticipated to produce sufficient proceeds to discharge a major portion of the potential IHT. Although it is difficult to forecast the ultimate IHT liability, given relevant financial advice it should be possible to make a reasonable estimate thereof.

13.4 There are two types of LAP which could be used to achieve the above objective, those being "term" and "whole-of-life" assurance. Each of those would pay a "lump sum" on death of the individual policyholder.

As its name implies, a "term" policy is written for a fixed period and if the individual survives that period, the policy would then lapse and no value would attach thereto. A "whole-of-life" policy is written on the basis that it will continue throughout the life of the individual and ultimately generate a lump sum on his or her death. In the case of a married couple, a whole-of-life policy could be written on what is known as a "joint-life" basis where the policy will "pay out" on the second death.

13.5 It is important to ensure that the proceeds from the LAP do not become part of the Estate of the policyholder as that would result in IHT being payable thereon.

Consequently, the relevant LAP should be written "in trust", usually for the children (or other parties) who are to benefit from the Estate. As the policy proceeds would not form part of the Estate, realisation is not dependent upon the obtaining of Probate. The LAP beneficiaries would provide the life assurance company with a copy of the Death Certificate and the proceeds could then be paid out to them. They, in turn, could utilise those funds in making payment of the IHT which would subsequently be refunded to them as and when the assets within the Estate are realised.

13.6 A "term" policy could be useful where an individual makes a substantial gift qualifying as a PET and wishes to insure against the possibility of his or her dying within the following seven years. The level of "cover" required would obviously take into account the "tapering" of the potential tax liability (referred to at paragraph 1.7 above) and this will be factored into the level of premia by the life assurance company.

13.7 Premia for LAPs would depend upon the amount of "cover" required, age of the individual or individuals concerned and their respective state of health when the policy is written. All such matters need to be discussed with an Independent Financial Advisor who should liaise with the individual's other professional advisors (accountant or solicitor) as regards the quantum of "cover" required and identity of the beneficiaries of the trust under which the LAP is written.

13.8 Generally, premia paid on LAPs would constitute PETs but, depending upon quantum, regularity of payment and the income resources of the individual concerned, may qualify for exemption as "Normal Expenditure out of Income".

14. Estimated Value of Estate

The table on the right should assist you in estimating the value of your "Estate" and the potential liability to IHT.

Estimate Value of Estate			£
Value of:	Your home (and contents)		
	Your business[1]		
	Bank/savings account(s)		
	Stocks and shares		
	Insurance policies		
	Car		
	Jewellery		
	Other assets		
Total assets			
Deduct:	Mortgage		
	Other Loans		
	Other debts		
Total liabilities			
Net value of Estate			
Add: Gifts in last seven years[2]			
Deduct (Nil Rate Band)			– 325,000
Taxable Estate	£		
Tax at 40%	£		

1. If you are not sure what your business is worth, we can help you value it. Most businesses currently qualify for Business Property Relief.
2. Chargeable and potentially exempt transfers.

IHT planning cannot be viewed in isolation of other taxes, particularly CGT. As mentioned, for CGT purposes, the gift of an asset other than cash is treated as a disposal taking place at "open market value" with a potential CGT liability arising. Consequently, as with all aspects of IHT planning, detailed professional advice is required.

It cannot be emphasised too strongly that before implementing any IHT mitigation strategy full consideration must be given to personal and familial requirements, present and future. There would be little point in denuding oneself of assets and thereby negating IHT liabilities if, by so doing, one were to jeopardise one's future quality of life.

A widow consulted this Firm as she was contemplating the transfer of her house to her son, purely to avoid IHT. She was asked to consider what would transpire if, at some future date, she required residential care which could only be funded from sale proceeds of the house; she automatically assumed that such would be forthcoming from her son. It was put to her that her son may then be influenced by other considerations such as the opinion of her daughter-in-law; the widow decided to retain her house!

Finally, a method of mitigating IHT is by indulging in "**SKI**ing" which need not involve travel to Switzerland but merely "**S**pending the **K**ids' **I**nheritance"!

Cohen Arnold

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This guide includes only a synopsis of the possibilities which exist for mitigation of IHT. Consequently, the comments contained in the guide should not be regarded as definitive professional advice and no action should be taken without detailed consideration of all relevant facts and circumstances and reference to the appropriate legislation. Accordingly the firm cannot accept any responsibility or liability for any action taken (or not taken) based upon the content of the guide.

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