



Personal Planning UPDATE

Safeguarding your estate

Considering what you want to happen to your estate when you die and how to minimise the tax liability.

Most of us are probably wealthier than we realise, particularly if we own our home. It is quite easy for a person living in a semi-detached suburban house to leave an estate worth more than £500,000.

The first step in estate planning is to make a Will. If you die without a Will, your estate will pass according to the laws of intestacy.

Remember to keep your Will up to date and ensure that your executors can find all your property.

Estates are subject to inheritance tax (IHT), which is charged at 40% on the value of your estate above £325,000. So for an estate of £500,000 the inheritance tax is £70,000 (40% of £175,000).

Reducing IHT

There are several ways in which IHT may legally be reduced. The first is to make use of the various exemptions and reliefs.

Businesses and farms can often be left without incurring an IHT bill by claiming **business property relief** or agricultural property relief. Those that do not qualify for a 100% tax relief may qualify for 50% relief and we can work this out for you.

Transfers between spouses or civil partners are exempt from IHT providing the transferor's spouse or civil partner is domiciled in the UK and that they were legally married to the deceased. Unmarried couples do not benefit from this exemption even if they have been together a long time, jointly own property or have children.

If the deceased were a widow or widower, the nil rate band can be up to twice the £325,000 figure. This is because whatever percentage of the nil rate band was unused when the previous partner died may be applied to the current nil rate band.

Example

A man dies in June 1996 leaving £50,000 to his children and £450,000 to his wife. In 2014 the wife dies, leaving £700,000 to her children.

Amount not covered by spousal exemption:	£50,000
Nil rate band in June 1996:	£200,000
Amount not covered as % of nil rate band:	25%

This means that 75% of the nil rate band was not used, as the rest of the estate passed under the spousal exemption. This means that the nil rate band for the death of the wife is 1.75 times the normal nil rate band.

This is:	$£325,000 \times 1.75 =$	£568,750
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The tax payable on the wife's death is:

Estate:	£700,000
Nil rate band:	<u>(£568,750)</u>
Taxable estate:	<u>£131,250</u>
IHT at 40%:	<u>£52,500</u>

Tax can also be saved by careful matching of parts of the estate to beneficiaries.

For example, suppose the deceased had an estate of £6 million of which half was a business that qualifies for business property relief, and half in cash. He wants to leave half of his estate to his wife and half to his brother.

If he leaves the business to his wife, the legacy to his brother is taxable. So IHT is payable on £3 million.

However, if he left the business to his brother and the cash to his wife, the whole estate is exempt from tax at this date. The business qualifies for business property relief and the cash from spousal exemption.

Charities

The rate of tax reduces from 40% to 36% if at least 10% of the net estate is left to a qualifying charity. The net estate is calculated after all IHT exemptions, reliefs and the nil rate band as well as any liabilities outstanding at the date of death have been deducted.

This reduction is not enough for the tax alone to pay for the charitable legacy; however, it can increase the rest of the estate where there is already a significant charitable legacy. Legacies to charities are free of tax.

Example

After allowing for the nil rate band and other exemptions and reliefs, the deceased left an estate worth £1 million of which 8% is left to charity. We compare that to the position if the deceased increases the charitable donation to 10%.

	8% legacy	10% legacy
Value of estate	£1,000,000	£1,000,000
Charitable legacy	<u>£80,000</u>	<u>£100,000</u>
Balance of estate	<u>£920,000</u>	<u>£900,000</u>
Tax at 40%/36%	<u>£368,000</u>	<u>£324,000</u>
Estate after charity and tax	<u>£552,000</u>	<u>£576,000</u>

So the charity receives another £20,000 and the other beneficiaries receive another £24,000.

In addition to qualifying charities, there are other bodies to which sums can be left tax-free. This includes cultural bodies such as museums, as well as the main political parties.

Gifts and exemptions

There are various exemptions and reliefs that reduce the taxable value of the estate. The main ones are:

- £3,000 annual exemption on all gifts to all donees
- £250 annual exemption on each gift made to any number of donees
- gifts in relation to marriage of up to:
 - £5,000 by a parent
 - £2,500 by a grandparent
 - £1,000 by anyone else.

Gifts made more than 7 years before a person's death are excluded from the estate. For gifts made between 3 and 7 years before death, part of their value is excluded.

A useful relief, often overlooked, are regular gifts made as part of your normal expenditure out of your after tax income, not your capital. These are exempt from IHT provided you have enough income left after making them to maintain your normal lifestyle.

There is no limit on the amount, so this can be used to transfer significant value and avoid increasing your estate. Examples may include regular monthly gifts out of income to support a family member or significant gifts for Christmas and birthdays each year.

Other methods

There are some other ways of seeking to protect your estate from IHT.

A **trust** can be an effective means of planning but care is needed as there are special tax provisions that we can explain to you.

A **deed of variation**, within 2 years of death, may also be an option for those who have recently inherited an estate but wish to pass it on to a younger generation.

Contact us

We can advise you on simple arrangements that can protect your estate so that you pay the minimum amount of tax.