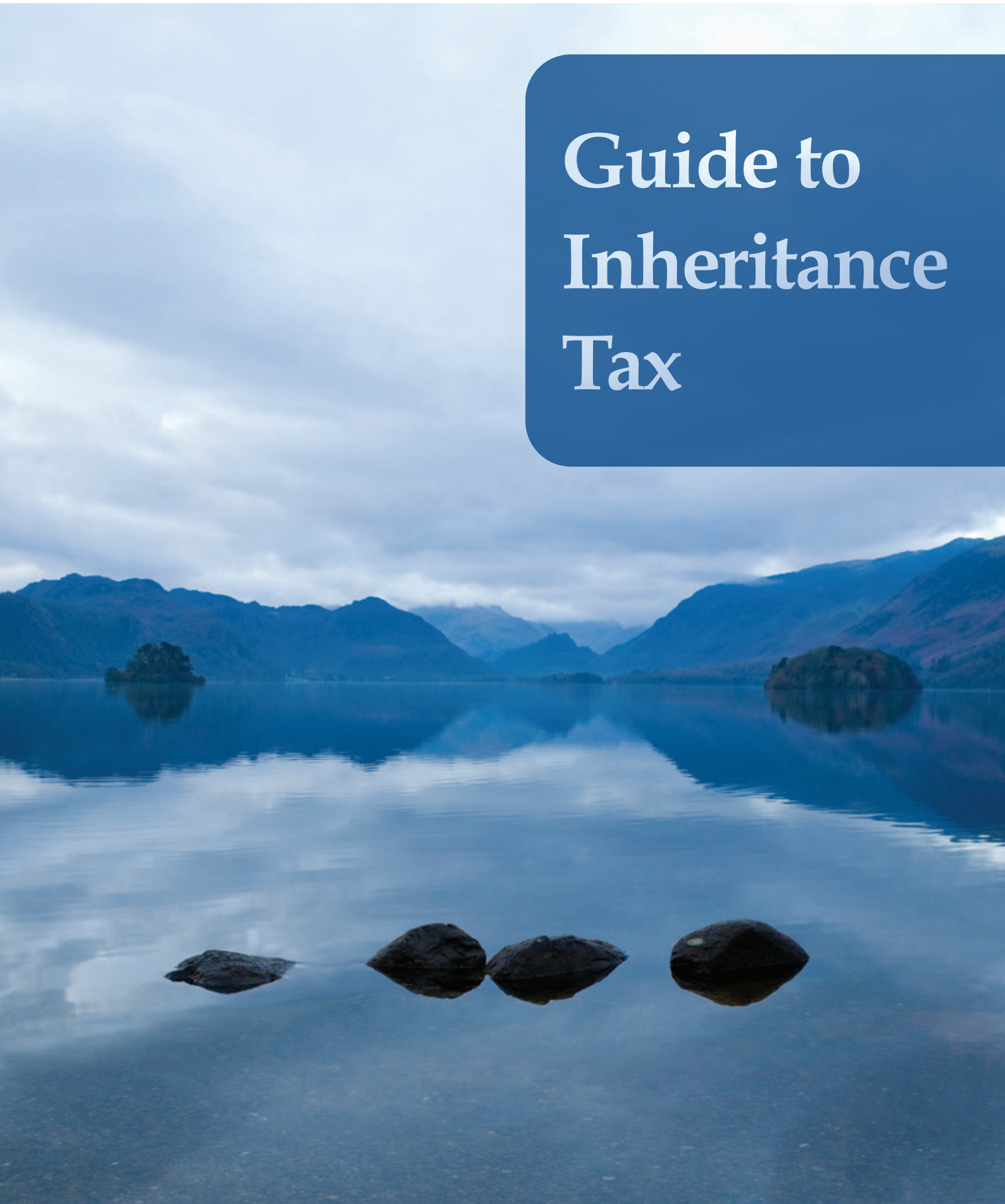




COCKBURN LUCAS  
INDEPENDENT FINANCIAL CONSULTING

# Guide to Inheritance Tax



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**This guide provides general guidance only and should not be relied on for major decisions on property or tax. You should consult a qualified Independent Financial Advisor or solicitor before taking action on inheritance tax.**

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“ Inheritance tax is sometimes referred to as a ‘voluntary’ tax, and with careful planning and expertise, this tax can be easily reduced in its entirety or substantially reduced.

We specialise in this area and have all the skill sets needed to find you a solution that not only meets the needs of your heirs, but more importantly meets your own personal requirements for either income or growth, as well as access to capital if applicable.

Don't volunteer to give HMRC a penny more than you need to and speak to us now for a non-obligation discussion on how we can help. ”

Mike Horseman, Managing Director  
Cockburn Lucas Independent Financial Consulting

# What is Inheritance Tax?

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We all know the old saying about the only certainties in life being 'death and taxes'. Inheritance tax (or 'IHT' for short) covers both. Put simply, IHT is a tax on the money or assets you leave behind when you die. It may also apply to some gifts you make while you're alive.

A certain amount of a person's estate, set by the government, escapes IHT. This is known as the 'tax-free allowance' or 'nil rate band'. Everyone in the 2009-2010 tax year has a tax-free allowance of £325,000. The allowance was scheduled to go up to £350,000 for the 2010-2011 tax year, but in November's Pre-Budget Report it was announced that it would remain at £325,000.

This means that a single person with an estate\* worth more than £325,000, who dies during the 2009-2011 tax years will have their estate reduced by a 40% tax on anything above £325,000.

\*This includes money, property and investments, after deducting any debts such as a mortgage and covering expenses such as funeral costs. For more details on what is included, see page 5.

**Example:** John Smith dies leaving an estate worth £500,000. The IHT bill will be £70,000 (40% on £175,000 - the difference between £500,000 and £325,000).



## Inheritance tax rules for married couples and civil partners

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Married couples and civil partners are allowed to pass their possessions and assets to each other tax-free and, since October 2007, the surviving partner is now allowed to use both tax-free allowances (providing one wasn't used at the first death).

This can effectively double the amount the surviving partner can leave behind tax-free, to £650,000 under current IHT rules.

## Why should I care about inheritance tax?

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IHT used to be a headache for only the very wealthy, but now an increasing number of people are affected by it because the value of their property has increased and pushed them over or near to the IHT threshold.

Although the government promised to raise the level in April 2010, it has since decided to reverse this decision partly as house prices have been falling. Even so, many more people than before are being affected so it's important to check your status and plan ahead to avoid the tax where possible.

If you don't plan ahead, your estate – assets that you have worked for and saved in your lifetime – could be eaten away by inheritance tax, reducing the value of what you can leave to your loved ones.



IHT used to be a headache for the wealthy but now an increasing number of people are affected by it because the value of their property has increased and pushed them over or near to the IHT threshold.

## Is my estate liable to inheritance tax?

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To see if your estate will be liable to IHT when you die, add up the value of everything you own in your name or a share of anything owned jointly, including:

- ✦ your house
- ✦ any investments
- ✦ assets held in some trusts from which you receive an income
- ✦ savings
- ✦ personal property
- ✦ the value of some life insurance policies

Also included are gifts from which you retain some benefit, so if you decided to give your house to your children but carry on living in it then it will still be included in your estate. This is called a 'gift with reservation of benefit'.

Next, add any financial gifts you have made in the past seven years (unless they are exempt, as described on page 11).

Now deduct any debts, such as outstanding mortgage or loan, and anything you want to leave to charity. You can also deduct the value of any gifts made on death that are exempt from inheritance tax and the reasonable costs of your funeral.

Once you have a figure, consider how your marital status affects the outcome:

<p><b>If you're single</b></p>	<ul style="list-style-type: none"> <li>40% IHT is due on the value of your estate over £325,000.</li> </ul>
<p><b>If you're married or in a civil partnership</b></p>	<ul style="list-style-type: none"> <li>Any of your estate to be passed onto your spouse will be transferred tax free.</li> <li>40% IHT is due on the value of your estate over £325,000 that is passed on to anybody other than your spouse.</li> <li>Your surviving spouse, now widowed, is then subject to IHT as outlined below.</li> </ul>
<p><b>If you're widowed</b></p>	<ul style="list-style-type: none"> <li>The tax-free amount available on your death depends on what your spouse left people other than to you when they died.</li> <li>If they passed on an estate worth MORE than £325,000 to anyone other than you, you WILL NOT benefit from their 'nil rate band'. Therefore 40% IHT is due on the value of your estate over £325,000 (i.e. your nil rate band) when you die.</li> <li>If they passed on an estate worth LESS than £325,000 to anyone other than you, you WILL benefit from part of their 'nil rate band'. Therefore 40% IHT is only due on your estate over £325,000 (i.e. your nil rate band) plus the value of their unused nil rate band, when you die.</li> <li>If they left you everything they have not used any of their £325,000 nil rate band, meaning you can combine theirs with your own. This means 40% IHT would be due on the value of your estate over £650,000.</li> </ul>
<p><b>If you're unmarried or not in a civil partnership</b></p>	<ul style="list-style-type: none"> <li>You are treated as single for IHT purposes.</li> <li>New laws in Scotland give unmarried couples some rights to each other's property on death or separation, but do not affect the IHT rules. The Law Commission has suggested similar changes in the law for unmarried couples in England and Wales but again, these will not change the rules on IHT.</li> </ul>

**Example:** Clare and Nick were together for eighteen years but never married. Their home, purchased together as tenants in common, is now worth £1,000,000. Nick also personally owns £25,000 in shares.

When Nick died his estate was made up of half the value of the house and the full value of the shares, making a total of £525,000. Nick's Will left everything to Clare.

As they were not married, he uses his full nil rate band allowance of £325,000 in passing his estate to Clare. This means that Clare must pay IHT at 40% on the remaining £200,000. Her savings (and the sale of Nick's shares) will not cover the £40,000 bill and so she must consider selling the house to cover the tax liability.

# Who pays the inheritance tax bill and when?

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Upon your death, your inheritance tax liability is usually paid from your estate.

If the tax is due on gifts you made during the last seven years before your death, the people who received the gifts must pay the tax due. If they cannot or will not pay, the amount due then comes out of your estate.

In most cases, IHT must be paid within six months from the end of the month in which the death occurs. If not, interest is charged on the unpaid amount. Tax on some assets, including land and buildings, can be deferred and paid in installments over ten years but if the asset is sold before all the installments have been paid the outstanding amount must be paid in full.



# Wills and basic planning



## Leave assets to your spouse or civil partner

Make the most of the easiest option – anything you leave in your Will to your spouse or civil partner is exempt from IHT and your IHT ‘nil rate band’ allowance isn’t used. As a result, your spouse will not have to face selling your home to pay for the tax and will have a double allowance when they die.

Also, any gifts between husbands and wives or civil partners are exempt from IHT whether they were made while they were both still living or left to the surviving spouse on the death of the first.

## The importance of making a Will

If on death you do not have a Will you will die ‘intestate’ and your estate may not be passed on in line with your wishes. This is of particular concern for couples who are not married or not in a civil partnership. If you have no close relatives and die intestate then the government can end up with your assets. It’s therefore crucial to make a Will even if you want to ensure that your estate is left to your favourite charity.

## Using your will for inheritance planning

Before the IHT laws changed, a common way to make sure your tax-free allowance was not wasted was to use your Will to arrange for assets or money up to the value of the tax-free allowance to be passed to someone other than your husband, wife or civil partner on the first death, or to be passed to a trust set up in your Will and from

which your spouse could benefit. However, now that an individual’s tax-free allowance can be passed on to a spouse or civil partner, this may no longer be necessary.

**Note:** Where a person has already died, their Will can be rewritten within two years of their death as long as all the beneficiaries agree – this is called a ‘Deed of Variation’. Where the person died more than two years ago it is not possible to rewrite the Will.

## Two deaths in five years

If someone dies within five years of inheriting property from an estate where IHT was due, the tax due on their death can be reduced. There is a rather complicated sliding scale of successive charges relief (or sometimes called ‘quick succession relief’) but it only applies if they paid tax on their inheritance. Seek advice from your adviser if you think this applies to you.

# Trusts

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A trust is an agreement between the creator of a trust, to make a gift of property to a trusted party to administer for the benefit of another.

- ✦ The creator of the trust is known as a 'settlor'
- ✦ The individuals in the trusted party are known as the 'trustees'
- ✦ The people who will benefit are known as the 'beneficiaries'

## Reasons for using a trust:

- ✦ Maintain some control over the asset as certain trusts allow you to easily change beneficiaries.
- ✦ More flexible than a will
- ✦ Generation skipping, allowing you to pass assets directly to grandchildren
- ✦ Hold assets for disabled or until minors reach 18 (or 25)



<p><b>Interest In Possession Trust</b></p>	<p>An interest in possession trust is one where the beneficiary of a trust has an immediate and automatic right to the income from the trust as it arises. The trustee must pass all of the income received, less any trustees' expenses, to the beneficiary.</p> <p>The beneficiary who receives income often doesn't have any rights over the capital of such a trust. Instead the capital will normally pass to a different beneficiary or beneficiaries in the future.</p>
<p><b>Discretionary Trust</b></p>	<p>In a discretionary trust, the trustees are the legal owners of any assets held in the trust. They are responsible for running the trust for the benefit of the beneficiaries, with 'discretion' about how to use the trust's income and capital. A discretionary trust may be set up to provide money for a future need that is not yet known - future grandchildren, for example.</p>

A discounted gift trust (DGT) is a type of discretionary trust arrangement usually set up in connection with an investment. It allows someone to gift a lump sum into a trust whilst retaining a life-long income from that money.

This is based upon a calculation as to the likely total amount of income that will be paid back to them by the trustees over their life. This amount is deemed to be a gift of zero value and is therefore free of IHT.

A discounted gift trust is a powerful planning tool for someone who requires an income for the remainder of their life, and can be combined with Business Property Relief investments (see later section) for multiple IHT benefits.

**Example:** Instead of each spouse leaving half of their house directly to their children they leave the value of it to a discretionary trust with the children as beneficiaries. On the first death the trust inherits half the house. The trustees then have a guarantee that the money owed will be paid when the surviving spouse dies. It's rather like an IOU and no interest is charged. When the second spouse dies, the rest of the value of the house passes into the trust which can then pay out to the heir/s. This legal mechanism stops the children owning any part of the property until the second parent's death. It is particularly useful in cases where there is a second marriage, a divorce, bankruptcy or even the need to claim means-tested benefits. A trust of this kind should be arranged by a solicitor as the trust rules are constantly reviewed and can be complex.

# Gifts

Give wisely - there are certain gift allowances that can reduce the value of your estate.

<b>Assets</b>	Any assets you give away will fall out of your estate for IHT purposes providing you don't die within seven years of making the gift*. These are known as 'potentially exempt transfers' (PETs) and they are an ideal way for someone in good health to start making gifts and reducing their IHT exposure during their lifetime. Money put into a bare trust where the beneficiary is entitled to the trust fund at age 18 or 21 counts as a potentially exempt transfer.
<b>Cash gifts and individual gifts of up to £250</b>	Some cash gifts are also exempt, and you can give away up to £3,000 a year. Parents can also give a wedding gift of up to £5,000, while grandparents can give up to £2,500. Wedding gifts to anyone else are exempt from IHT up to £1,000. You can also make individual gifts of up to £250 to any number of recipients each year. However, these recipients cannot also get money from you under any other exemption.
<b>Charities</b>	You can give money to charities, national museums and the main political parties, the National Trust, art galleries and most registered housing associations without any IHT liability.
<b>Maintenance gifts for ex-partners</b>	If you make a gifts to your ex-spouse or ex-civil partner for their maintenance these are exempt.
<b>Gifts to children</b>	Gifts to your children (but not grandchildren) are exempt while they are in full time education providing the cash is for their maintenance or the costs of their education or training. This includes paying off a student loan.
<b>Regular gifts</b>	Regular gifts from after-tax income, such as a monthly payment to a family member, are also exempt as long as the giver still has sufficient income to maintain their standard of living.



*\*If someone makes a large gift or a number of smaller gifts that total more than the nil rate band, and they die within seven years of making it, then tax is due on that gift and has to be paid by the recipient. If they die within three years full tax is due, but it is reduced by 20% for each year or part of a year over three. If you are in this position seek professional advice.*

# Business property relief

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Business Property Relief (BPR) can be a valuable relief from inheritance tax. It allows you to claim relief on business assets that you own, including qualifying businesses that you hold shares in.

## There are a few key constraints on companies which qualify for BPR:

- ✦ They must be an unquoted company, although AIM and Plus Markets (OFEX) companies are deemed unquoted
- ✦ The company must actively trade, not just be an investment company
- ✦ There are some trading activities which are deemed not qualifying

Some investment companies offer products that look to specifically address IHT through Business Property Relief. They invest your money into a portfolio of selected BPR qualifying businesses, such as AIM listed or unquoted companies, to deliver this IHT relief in a simple structure.

## There are a number of investment rules relating to these products:

- ✦ They must invest your money and hold qualifying assets for two years to qualify
- ✦ They must replace any companies sold from the portfolio within three years
- ✦ The assets (and therefore your investment) must be held at time of death for IHT relief

It should be noted that spousal transfer does not 'restart the two year clock', meaning the investment can be passed between spouses with the assets continuing to count towards the two-year holding target.

## Reasons for using a BPR solution

### Improved access and control

You retain access to your investment. So if your circumstances change and you want to dispose of your holding and get your money back, you can. However, money taken out of the investment may not be shielded from inheritance tax.

### Faster 100% IHT exemption

Unlike gifts and simple transfers into trust, which generally take seven years before they're fully exempt from inheritance tax, BPR investments are exempt after just two years (provided the investments are held at the time of death).

### Income options

Many BPR solutions allow you to take an income from your investment.

### Simplicity

Although it is very important to take financial and/or legal advice to determine if they are right for you, BPR investments are relatively simple (compared to trusts). Generally there are no complex legal structures, and there may not be a requirement for client underwriting or medical surveys.

# Equity release

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If all your wealth is tied up in your property, you may not be able to make use of gifts during your lifetime or spend your wealth on yourself. To overcome this, some people consider an equity release scheme. These allow you to either borrow money against the value of your home (known as a lifetime mortgage), or sell part of your home at a reduced market rate, but remain living there throughout your life (a home reversion scheme).

The money you release can be passed onto your heir(s) and, providing you survive the gift by seven years, there will be no tax to pay. Alternatively you could invest the money in a Business Property Relief investment solution, and provided you survive two years, there will be no tax to pay. Of course you can also always spend it on yourself.

When you die, the value of your estate will be reduced by the mortgage debt (with a lifetime mortgage) or because only part of the value of your home will still belong to your estate (with a home reversion).

## The pitfalls

It sounds simple enough, but think carefully before going down this route. With lifetime mortgages interest is 'rolled up' and your debt can swiftly grow. For example, a £50,000 mortgage with an interest rate of 7% a year will have almost doubled within 10 years. While you are alive you pay no interest on the loan but the money will be deducted from your estate when you die.

With the home reversion route, you are selling off part of your home for less than its full value. So think about whether you're willing to let the bank take half of your home, just to stop the tax man getting a slice.

If you do think equity release might be for you, don't make the decision lightly or quickly. Talk to your heir(s) and make sure you consult an independent financial adviser who specialises in equity release before going ahead.



## Do I need to keep records?

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Although there is no formal obligation to keep records of gifts (whether they are exempt or not) that you make while you are alive, there is an obligation on your executors to discover them all and to make sure the correct inheritance tax is paid. So it is very helpful to your executors – who will normally be your heirs – to keep a note of gifts that you make. If you think they are exempt gifts then explain why. Keep these documents with your Will or other papers so that they are easily found.

Another very good reason to keep detailed records is that everything left in one partner's estate is key to calculating the allowance on the second spouse's estate. In many cases estates where no tax was due did not have to be notified to HMRC and no official records exist. However, once probate is granted wills are public documents which can be accessed by anyone. So if the first partner to die left a Will then a copy of it can be obtained through the court system for a small charge. Contact the Probate Registry in England and Wales, the local Sheriff Court or National Archives in Scotland and the Public Record Office in Northern Ireland.



# Where to get help and advice

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Bequeathing assets can be complicated, so it's important to get legal advice from a solicitor, tax adviser or independent financial adviser.

There is some useful basic information on the HMRC website [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

To arrange a no obligation meeting call us now on 0115 9819 529 or email: [enquiries@cockburnlucas.co.uk](mailto:enquiries@cockburnlucas.co.uk)

Or visit us at  
[www.cockburnlucas.co.uk](http://www.cockburnlucas.co.uk)  
for more guides to investing and making the most out of your money



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