

Inheritance tax: planning for your family's future

Inheritance tax is no longer a tax just on the rich. The rapid rise in house prices over recent years, combined with inadequate increases in the threshold at which inheritance tax starts, means that more and more people could see their children's inheritance significantly reduced. However, with advance planning you can take action now to ensure your family rather than the government benefits from your estate.

The threshold at which inheritance tax starts is known as the nil rate band and for the current tax year is £300 000. Government figures show that since 2000 the nil rate band has risen by just 28.2% while the average house price has seen an increase of 125.9%, according to Nationwide Building Society. If the nil rate band had moved in line with house price inflation since 2000 it would now be £528 600. According to Halifax, the number of owner-occupied properties in the UK valued at more than the current inheritance tax threshold stands at 2.3 million or 12% of properties. By 2020 it projects that this number will rise to 4.3 million.

Isn't inheritance tax planning something I should consider later in life?

You're never too young to start planning for inheritance tax. It's not age that's important but how much you're worth. Once the value of your estate – which includes your home and its contents, your savings and investments and any other assets you own – exceeds the nil rate band, inheritance tax kicks in at 40%. In other words, if your home and its contents is worth around £350 000 and you have savings and other assets valued at £100 000, you are already £150 000 over the threshold. This means your estate would face a £60 000 bill.

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So what steps can I take to help avoid this?

Fortunately, there are a number of things you can do now which can reduce your potential inheritance tax liability in the future. You can, for example, make a gift of up to £3000 each year free of tax and any part of this allowance not used in one year can be carried forward to the next. Regular gifts out of income are also permitted with no monetary limit, providing they do not impinge on your normal standard of living.

What if I want to gift lump sums of more than £3000?

Larger lump sum gifts can also be made during your lifetime up to the nil rate band

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free of inheritance tax. They will not be counted as part of your estate on death providing you live for at least 7 years after making the gift. If you survive 7 years, the nil rate band will become available again so – if you have enough free capital – you can go on making further gifts up to that level every 7 years. The cumulative effect of this can be huge. At current rates, a tax saving of up to £120 000 can be made every 7 years.

But what if I want greater control or access to my money?

You can, if you prefer, put the gift into a trust rather than give it to individuals. The benefit of this is that gifting to a trust can help you save inheritance tax while allowing you to retain control over the money, as you don't have to hand it directly to your beneficiaries.

Some people will not be able to afford to give away much money while they are alive. They will need access to their capital or to the income it generates in order to supplement their pension. There are still options to reduce inheritance tax even in these circumstances.

One option if you need an income from your capital is to set up a discounted gift trust. This arrangement normally uses a life insurance investment bond. Under the

terms of the trust, you will remain entitled to fixed, regular income-like payments for the whole of your life, which are paid in the form of tax-deferred withdrawals from the bond. The attraction of this trust is that the value of your gift will be discounted, i.e. reduced, immediately to reflect the income you will take out and your life expectancy, so if you die within 7 years, the potential tax bill is reduced. All of the money is outside your estate after 7 years and yet you still benefit from the regular income-like payments.

Alternatively, you could set up a loan trust. As with the discounted gift trust, your money is normally put into an investment bond subject to trust, but with this arrangement you will retain full access to your capital. Basically you are making an interest-free loan to the trust, which is repayable

on demand. However, any growth in your investment will be outside your estate and therefore free of inheritance tax and will be held in trust for your beneficiaries. Thus, you are reducing any further growth in your estate and hence capping the potential inheritance tax liability.

If you are married or in a civil partnership you could split your assets so they are owned equally, allowing you and your partner to leave your individual share of the assets to other beneficiaries on your death, thereby making use of all or part of the nil rate band. This can mean potential inheritance tax savings at current rates of £120 000 (40% of £300 000). You can do this through your will, for example by creating a trust. It is also possible to use the family home in this way but careful consideration is required before doing this.

Conclusions

There are a number of ways of reducing inheritance tax bills. It is very important to consider fully all of the options available to you and expert advice is essential in helping you make the right decision to suit your circumstances. **BJHM**

The above information does not constitute financial advice. For further information please speak to your financial adviser.