

# Inheritance tax: planning for your family's future

\* Inheritance tax is no longer a tax just on the rich. Even taking into account the current downturn in the property market, house prices have still risen rapidly over recent years. This fact, combined with relatively small increases in the threshold at which inheritance tax starts, means that more and more people could see their children's inheritance significantly reduced. However, inheritance tax is a tax that you can plan for. This article explains some of the steps you can take to ensure that your family and not the government benefits from your hard work once you're no longer around to reap the rewards.

The threshold at which inheritance tax starts is known as the nil rate band and for the current tax year it is £312 000. Since 2000 the nil rate band has risen by just 33.3%, while the average house price has seen an increase of 140.4%\*. If the nil rate band had moved in line with house price inflation since 2000 it would now be £562 500.

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

You are never too young to start planning for inheritance tax. It's not age that's important but how much you are 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 are worth around £352 000 and you have savings and other assets valued at £100 000, you're already £140 000 over the threshold. This means that there would be a £56 000 bill on your estate.

## So what steps can I take to help avoid this?

There are a number of steps you can take now which can reduce your potential inher-

\* Average house price information from Nationwide; nil rate band statistics from HM Revenue & Customs.

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itance tax liability in the future. For example, you can 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 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 £124 800 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 won't 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 income. 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 in to 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 therefore capping the potential inheritance tax liability.

In October 2007 the government announced new inheritance tax provisions so that when the first partner in a marriage or civil partnership dies, any proportion of the nil rate band left unused on their estate can be transferred to the estate of their surviving partner. So, for example, Mr Smith died in 1995, leaving all of his estate to his wife. None of his nil rate band was used, as a transfer between spouses is exempt from inheritance tax. When Mrs Smith dies in May 2008, with a total estate of £600 000, the nil rate band is £312 000. The inheritance tax due on her estate would be £115 200, except that as 100% of Mr Smith's nil rate band went unused on his death, the nil rate band on Mrs Smith's death is increased by 100% to £624 000. Consequently on her death, a charge to inheritance tax is completely avoided. This was widely reported as a 'doubling of the nil rate band' but this is misleading. The revision only applies where the surviving partner died on or after 9 October 2007 but it does not matter how much earlier the first partner died.

## 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.