

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 are 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 £325 000. Since 2000 the nil rate band has risen by just 38.9%, while, according to figures from Nationwide, the average house price has seen an increase of 93%. If the nil rate band had moved in line with house price inflation since 2000 it would now be £451 620.

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

You are never too young to start planning for inheritance tax. It is not age that is 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 is worth around £365 000 and you have savings and other assets valued at £100 000, you are 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-

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

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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 £130 000 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 do not 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 income. However, 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 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 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.

Since October 2007, spouses and civil partners have been able to transfer their nil rate band allowance so that any part of it left unused when the first partner dies can be transferred to the surviving partner's estate. This only applies where the surviving partner died on or after 9 October 2007 and it does not matter how much earlier the first partner died. Even with this provision many couples could still find that the value of their combined estate is such that there will still be an inheritance tax liability.

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**

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