

Passing money to the next generation

There are very few taxes you can plan for, but inheritance tax is one of them. With some careful planning you can ensure that your loved ones benefit from your legacy and not the government through a sizeable tax bill.

How much can be payable?

Inheritance tax is payable if your estate, which includes property, savings and investments, is valued over the current nil rate band threshold of £325 000. The tax is payable at 40% on anything over this amount.

For example, if your home and contents are worth £350 000 and your savings and other assets are valued at £100 000, the total value of your estate is £125 000 over the nil rate band threshold. Currently this would leave your family with a £50 000 tax liability.

Transfers between spouses and civil partners during their lifetime or on death are exempt from inheritance tax. It is also possible to transfer any unused nil rate band from a late spouse or civil partner to a surviving spouse or civil partner on their death. This can increase the second partner's inheritance tax threshold from £325 000 to as much as £650 000.

The value of your estate

Although these figures sound significant, they might not be as generous as you expect and before you start any form of inheritance tax planning it is important that you understand the value of your estate. This can include things like property, cars, art, jewellery and investments.

Property in particular could have a big impact on the size of your estate without you realizing, especially if you have owned it for a number of years. The average house price has increased 45% since 2002 and 221% since 1992. Coupled with any growth in your savings and investments, it could mean your estate is more valuable than you think.

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Insure against any tax liability

It is possible to protect your family against a sizeable and unwelcome tax bill through insurance, and the earlier you look at this option the less costly the premiums are likely to be.

This would mean taking out a whole of life insurance policy that will cover any potential inheritance tax which would become due on your death. It is important to write the policy in trust to ensure that it does not form part of your estate. This will also ensure that the policy proceeds are paid out before probate is granted, allowing the recipients of your estate to pay any inheritance tax as soon as it is due.

Stop your inheritance tax situation getting worse

One of the simplest ways to decrease the size of your estate is to gift part of it to recipients before you die.

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You can make gifts of up to £3000 each tax year, which will be free from inheritance tax when you die. Any unused part of this exemption can be carried forward to the next tax year. You are also allowed to make unlimited regular gifts out of your income, provided the remaining income is sufficient to maintain your normal standard of living.

Lump sum gifts of more than £3000 can be made during your lifetime up to the nil rate band. However, if you die within 7 years of the gift being made it will still count as part of your estate. If you survive 7 years, the nil rate band will become available again so you can go on making further gifts up to that level every 7 years.

Other lifetime gifts that are exempt from inheritance tax include small gifts up to £250 per person along with gifts made in consideration of marriage. For example, each parent of the couple can gift £5000,

and grandparents or great grandparents can gift £2500 each.

If you prefer to retain control of your money, gifts can be made into trust rather than directly to individuals. Depending on the type of trust chosen they can provide you with the flexibility to set the level of control and access to the money, as well as receiving an income.

For example, there is a discounted gift, which is made up of two parts. There is a life insurance investment bond into which the money is invested, and a trust that allows you to receive regular, fixed withdrawals that represent the return of the capital not given away. The withdrawals are paid for as long as you are alive, in the form of tax-deferred withdrawals from the bond.

The value of your gift for inheritance tax purposes is the original investment minus the 'discount', which is the money you are likely to get back in the form of

regular withdrawals based on your life expectancy. Provided the value of the gift when combined with any others made in the last 7 years is less than the nil rate band, there will be no immediate inheritance tax to be paid. In addition, after 7 years

the gift will be outside your estate and not liable to inheritance tax, and you will continue to benefit from the ongoing regular withdrawals.

This type of trust provides an immediate reduction in the value of your estate by the value of the 'discount', and any future investment growth will also be outside of your estate. However, this trust is only suitable if you need and can spend the income. If the income is not spent then it will build back up in the estate potentially increasing the inheritance tax liability.

Conclusions

Because of the rules and complexities around planning for inheritance tax, you should always take expert advice as early as you can. **BJHM**

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