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# Article topic: Tax Planning

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## Protecting the family silver

One of the biggest tax bills people get is often their last, especially if there's property involved, but the earlier you start planning for Inheritance Tax, the more you could save.

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Traditionally, people didn't start thinking about Inheritance Tax (IHT) until they retired; however, with average house prices now more than £350,000*, people are acting much earlier to mitigate this 40% tax.

### How to achieve 0% IHT

If you are married with no children then your IHT situation is relatively simple, as all your assets can be transferred to a spouse/civil partner at 0% tax. However, the full 40% rate of tax applies to those assets on the death of your spouse/civil partner, or if you are leaving assets of more than £325,000 to anyone else. Without any IHT planning, for example, an estate worth £1m would normally incur a tax bill of £270,000, leaving just £730,000 to be shared amongst the beneficiaries. But, whatever your age, there are ways to mitigate IHT completely.

### Our top five tips

- **Lifetime gifting out of income -** this is a very underused, but effective way of getting 0% IHT on surplus cash. You can make regular payments into a stakeholder pension or trust for your children or grandchildren, for example, over a number of years free of IHT.

- **Maximise your own inheritance –** it is possible to reduce the IHT on an estate you are due to inherit with some forward planning. A common scenario is to have a lone elderly parent living in a large property. If you have surplus cash, you could loan it to your parent against the cost of their property. This reduces the net value of the estate and the overall amount of IHT. There are also last minute tax planning options available through so called 'deathbed' planning. These include flexible investments, such as Excluded Property Trusts, which don't require a minimum holding period, but are exempt from IHT.

- **Set up a trust –** you can put your life assurance, pension death benefit, or business assets into a pilot trust that attracts business property relief, whilst being exempt from IHT. Additional excess income and investments can also be placed in a Discounted Gift Trust, which has the same benefits and you can also start using your nil rate bands with lifetime Discretionary Trusts.

- **EIS investments** – these give upfront income tax relief of 30%, as well as qualifying for business property relief. This means if the investment is held for two or more years it is exempt from IHT. It is also exempt from Capital Gains Tax if held for more than three years. EIS investments can be started for a relatively small amount of cash which can be added to in later years.

- **Small gifts -** you can give away £3,000 free of IHT every tax year. If you don't use the full exemption in one year you can carry it forward, but only for one year. This 'annual exemption' can also be combined with the 'wedding/civil partnership ceremony gift exemption' of £5,000 per child, so that you can gift a total of £8000 free of IHT if one of your children gets married or forms a civil partnership. There are further 'wedding/civil partnership ceremony gift exemptions' for remoter relationships. Furthermore, gifts of up to £250 per person are also exempt from IHT; however, you are not permitted to use this allowance with the 'annual exemption'.

## Example – How to save £1.2m in Inheritance Tax

**The situation:**

Mike is 55 and divorced with three adult children. He owns a number of properties:

- A main UK residence worth £1.2m
- A holiday home in Gstaad worth £700,000
- A property portfolio with equity of £5m which generates a net income of £220,000 annually

Mike needs an annual income of around £100,000 to fund his lifestyle. He has life assurance of £1m, plus cash set aside for a rainy day of £300,000. Other than helping out his children when they need it and buying their first homes, he has no other IHT planning and has no will.

**The solution:**

By taking a few simple steps, Mike is able to reduce the IHT bill on his estate by £1.2m.
1. First, he writes a will. This can be updated to include the setting up of any future trusts and tax efficient investments.

2. Next, he places the £1m life assurance into a trust. This means it is no longer subject to IHT, saving £400,000.

3. Lastly, he increases his overall borrowing on some of his properties by £2m and uses the proceeds to invest in IHT efficient investments which qualify for business property relief. This reduces his IHT liability by a further £800,000.

**Other options:**

On top of the £1.2m saving, Mike's children can receive even more of his wealth if he carries out additional IHT planning:

- He can gift up to £40,000 per year in regular payments to each of his children. This does not reduce the value of his estate, but reduces the rate at which it will increase further.

- He can set up a discretionary trust for his children and other potential beneficiaries, or include provision for such a trust in his will.

For more information on these opportunities, please contact a member of the Tax Planning team.

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*The average cost of a detached house in the UK was £352,699 (October – December 2010), according to the Land Registry.