

An Introduction to Inheritance Tax

This is one of a series of Fact Sheets provided by J. & H. Mitchell, W.S.

Inheritance Tax is currently charged at a flat rate of 40% on (a) your estate as at the date of death and (b) any gifts made by you in the seven years prior to your death. It is also charged at a flat rate of 20% on certain lifetime transfers, principally on transfers to most Trusts.

General Exemptions

This general position is subject to the following exemptions:

1. Any gifts made by you or transfers of your estate on your death, up to the total 'lifetime exemption' (technically known as the 'nil rate band' – see separate section below).
2. Any gifts made by you more than seven years before your death.
3. Any gifts to your spouse.
4. Any gifts to charities.
5. Any gift of up to £5,000 to a child in contemplation of his or her marriage or up to £2,500 to a grandchild in contemplation of his or her marriage.
6. Any gifts made by you up to £3,000 in total value each financial year.
7. Any 'small gifts' of up to £250 each given by you to different beneficiaries in respect of Christmas, birthdays, etc.
8. Any gifts made by you which are classified as 'normal expenditure out of income'.
You need to be able to demonstrate that you were able to afford to make these gifts

out of surplus income (rather than coming from your capital) and that there is a pattern of such expenditure, for example by your making an annual commitment towards the premium on a life policy, or a termly commitment towards a grandchild's school fees. In many cases it is prudent, not only to demonstrate the pattern but also to ensure continuity of the benefit of your gifts, for a provision in your Will to confirm the continuity of the gift, for example the payment of a life premium for a remaining period of years, or the continuity of a termly contribution towards school fees up to the end of, say, secondary education of the beneficiary in question.

Reservation of Benefit

For a gift to be effective, you cannot retain any benefit in it. Thus, for example, were you to make a gift of a valuable painting to one of your children, the gift would not be effective for Inheritance Tax purposes if it remains on your wall rather than being physically handed over to the recipient. Likewise, if you endeavour to make a gift of part or all of your house to one or more of your children, this would be ineffective if you were going to continue living in the house, unless you were to pay an open market rent to the children.

Record-Keeping

If you are going to make any gifts in terms of any one or more of the above list, it is essential that you maintain an accurate record of the date on which the gift is made, what the gift comprises, to whom it has been made and, if it is not in cash, what its value is and how that value has been ascertained. It is usually sensible also to obtain a written receipt from the person receiving the gift, dated and signed by them, to confirm their actual receipt of the gift. You should maintain these records carefully, or better still hand them to us as and when such gifts are made. This is because it is increasingly common now for the Inland Revenue, after someone's death, to require full evidence of any gifts made.

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Life Policy

It is also possible for you to take out a Life Policy, notwithstanding your current age (especially if under 75), whereby you use the annual exemption of £3,000 (referred to at item 6 above) to pay the annual premium on a Life Policy. The Life Policy is either written in trust by you in favour of your children, or otherwise is taken out by them on your life. In either event, the value of your assets would be reduced by the annual premium of £3,000 which you would pay, whilst the lump sum payable from the Life Policy on your death would not form part of your Estates but would belong tax-free to your children. In this way, a reasonable fund can be transferred tax-free to them on your death and the cash may well be handy to them to enable them to put towards any Inheritance Tax bill chargeable at that time.

Transferable Nil Rate Band

Under current tax legislation each individual is allocated an Inheritance Tax exemption called the **Nil Rate Band**. This is the amount of the individual's estate (including gifts made in the 7 years before death) on which Inheritance Tax is charged at 0%. The Nil Rate Band for the 2012/2013 tax year is £325,000. Any estate which exceeds the Nil Rate Band is liable for Inheritance Tax at the current rate 40%. Careful lifetime tax planning to utilise other available allowances and reliefs (see above) can reduce this tax liability further but the most valuable and predictable allowance is the Nil Rate Band.

For married couples and civil partnerships anything left bequeathed, gifted or transferred to the surviving spouse or civil partner in lifetime or on death is free from Inheritance Tax. Until October 2007 the "use it or lose it" aspect of the Nil Rate Band meant that married couples and civil partnerships faced the dilemma of wanting to leave everything to their spouse or civil partner tax-free on the first death but at the risk that the aggregate estate of the survivor would be subject to Inheritance Tax; or utilising some or all of their Nil Rate Band for children or for a trust but leaving their spouse less well provided for. The

booming property market meant this could be an especially difficult decision for those whose only substantial asset was their family home.

In 2007 legislation was introduced to allow the transfer any unused portion of Nil Rate Band from the estate of the first to die to be transferred to that person's surviving spouse or civil partner, so as to reduce Inheritance Tax Liability on the second death. The effect of the transferable Nil Rate Band is that spouses and civil partners can jointly own an estate worth two Nil Rate Bands (currently £650,000) without incurring any Inheritance Tax liability within that limit.

The transferable Nil Rate Band can be backdated where a surviving spouse or civil partner was living after 9th October 2007. If a married individual died before October 2007 and did not use up the full Nil Rate Band available, this can now be transferred to the surviving spouse. However, unused nil rate bands from previous spouses remain specific to the widow/er and cannot be transferred to their new spouse.

The Nil Rate Band does not have to be transferred. There are circumstances in which it may be preferable to utilise the full Nil Rate Band on the first spouse's death. Professional advice should always be sought when drafting a Will to ensure the desired result is achieved.

It is important to realise that the Nil Rate Band applies both to the estate of the deceased and to gifts made by the deceased within 7 years of his or her death. Most lifetime gifts (except those to trusts) are potentially exempt from Inheritance Tax (see above). When assessing the availability of Nil Rate Band, lifetime gifts should always be investigated and taken into account.

The transferable Nil Rate Band has some further implications:-

1. Wills prepared before October 2007 may contain provisions to utilise the Nil Rate Band, which are strictly no longer necessary;
2. careful record-keeping of valuation and distribution of estates is now required;
3. there may still be occasion to use a Deed of Variation so as to vary a deceased's Will for tax purposes, with the consent of all the Executors and the relevant beneficiary or beneficiaries, within two years after the date of death.

**Each person's situation is individual and we are happy
to provide you with detailed advice on Inheritance Tax on request.**

*Although carefully prepared, this Fact Sheet is a guide only
and is not intended to be comprehensive. Tax law can be changed at any time.*

Specific advice should be requested on your own individual situation.

2012 edition