

Inheritance Tax

and what you can do about it

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Withers LLP is a leading law firm, which works closely with many UK charities advising on legacy and Inheritance Tax issues. The firm has worked with PDSA for more than 17 years and has provided the legal content for this publication.

About Inheritance Tax

How your estate may be liable for Inheritance Tax.

It wasn't too long ago that the only people likely to be troubled by Inheritance Tax were those who owned several Rembrandts and 20,000 acres of Wiltshire.

Today that has changed. Even if you own no Old Masters at all but just a modest semi, the fact is that Inheritance Tax may well affect your estate.

The change is almost wholly due to the dramatic rise in house prices that took place before 2008, which means that many homeowners are now over the threshold for Inheritance Tax.

The level at which Inheritance Tax starts, the nil rate band, is £325,000 and will remain at this level up to and including the tax year 2017/18.

Your estate (what you own when you die) could include your house, stocks and shares, insurance policies, PEPs/ ISAs and savings accounts. If, when all of these assets are added together, they total less than £325,000, your estate comes within the nil rate band. The tax on the nil rate band is 0% and so the estate pays no tax at all.

It is important to note that assets owned in joint names will often not form part of your estate for distribution purposes. Instead, they pass automatically to the survivor unless they are owned in separate shares. Assets owned in joint names will still normally form part of your estate for Inheritance Tax purposes unless passing to your spouse/civil partner.

However, for every penny above £325,000, Inheritance Tax is payable and this is charged at the rate of 40% (subject to any exemptions or reliefs, notably, spouse/civil partner exemption), even if you only ever paid basic rate income tax beforehand.

What happens if you haven't written a will?

An increasing number of people do now write a will.

With a properly written will, you can appoint the people you trust to be your executors and to distribute your estate. You can also specify exactly how your assets are to be disposed of.

But, even now, thousands of people die each year without leaving a will: they die 'intestate', as the legal jargon describes it.

The trouble with this is that the distribution of the estate of an intestate person must follow rigid rules, depending on whether the deceased was married or had a registered civil partner, whether they had children (of any age) and also the value of the estate.

Some people think their spouse/registered civil partner will inherit everything, but this is not always true.

Depending on the value of your estate, if you have children and other relatives, they may well be entitled to a share of your estate whether you want them to have something or not.

And if you have no surviving relatives, the whole of your estate goes to the Crown.

Your estate will incur Inheritance Tax at 40% if the chargeable value after exemptions exceeds £325,000.

Gifts to UK charities are exempt from Inheritance Tax

One of the simplest ways to control how much Inheritance Tax is payable is to write a will – and, if you choose to do so, you can avoid, or at least defer, Inheritance Tax by leaving your estate to your spouse or registered civil partner.

Rules were changed in the 2008 budget meaning that, while the £325,000 nil rate band has not been increased, married couples or registered civil partners are now able to transfer any unused nil rate band allowance to their spouse or registered civil partner when they die.

Additionally, these rules have been backdated (although there are problems if the first spouse died before November 1974) so that many widows or widowers will be able to use both their own and their partner's nil rate band allowance when they die.

This means that there could potentially be the equivalent of both nil rate bands i.e. £650,000 on the second death if everything had passed to the spouse on the first death.

However, it must be remembered that there has been no change for single people, couples who are not married or not in a registered civil partnership.

There is one other gift that you can make in your will that is also entirely free of Inheritance Tax. If you choose to leave your estate, or part of it, to a UK charity whose work you particularly admire, this gift will not be liable to Inheritance Tax.

There is no limit as to how much you can leave under this rule. The charity you choose to leave your money to does not pay inheritance tax either – so every pound you leave to your chosen charity can be spent on the cause you wish to support.

How to reduce your Inheritance Tax bill

So, as we've said, your estate is likely to be liable to pay Inheritance Tax on any amount that does not either pass to your spouse or registered civil partner or is in excess of the nil rate band of £325,000 (or £650,000 with the transferable nil rate band).

But there are ways to ensure that more of what you have earned is given to the people and causes that you choose, rather than taken by HM Government.

Most transfers during lifetime or on death between husband and wife or registered civil partners are not subject to Inheritance Tax. You can also make small gifts to anyone during your lifetime, of up to £250, without being taxed – and total gifts in any one year, up to £3,000, are also exempt. If your son or daughter, grandchild, nephew or niece is getting married, wedding gifts to them are also free from Inheritance Tax within specified limits.

Indeed, you can make gifts of any amount to individuals during your lifetime up to the nil rate band without paying Inheritance Tax, provided you do not retain any benefit from the gift. This will reduce the value of your nil rate band for the next seven years.

And, if you make a gift of any amount above the value of the nil rate band to any individual during your lifetime, that gift will be free of Inheritance Tax as long as you survive for seven years or longer. It is also a condition that you do not retain any benefit from the asset you give. None of these issues arise if the total of the gifts you make during the last seven years of your life is less than the nil rate band. No Inheritance Tax is payable in this case although the amount of the nil rate band available on death is reduced.

How to reduce your Inheritance Tax bill (cont'd)

Through the Legacy 10 initiative, as described on the following page, it is possible to increase charitable legacies while minimising, and sometimes avoiding, any reductions in what the other beneficiaries will receive.

Gifts to UK charities are exempt from Inheritance Tax. PDSA's online inheritance tax calculator is intended to provide a simple guide to show how leaving a gift to charity in your will could change the amount of IHT your estate would pay.

We recommend that you seek independent advice before undertaking any individual tax planning or the preparation of your will. You may also find the following HMRC link helpful:

<http://www.hmrc.gov.uk/inheritancetax/pass-money-property/charity-reduce.htm>

LEGACY10 Inheritance Tax relief for charitable giving

In the 2011 budget the Chancellor announced legislation that relates to deaths occurring on or after 6 April 2012. In broad terms, where an individual leaves at least 10% of their net estate to charity on death, the part of their estate that is taxable for Inheritance Tax purposes will be taxed at a reduced rate of 36% rather than the usual 40% Inheritance Tax rate. The scheme does not necessarily mean that less tax is payable but it can enable people to give larger gifts to charity without reducing the amounts they want to pass to non-exempt beneficiaries.

The rules for calculating the net estate are complicated. In cases where there are several elements that need to be taxed, such as when the deceased owned jointly held assets passing by survivorship or held a life interest in a settlement, each element (called a 'Component') must be examined separately.

The Components are:

- i. The Survivorship Component – the joint asset passing by survivorship;
- ii. The Settled Component – the deceased's interest in a Settlement or Will Trust, which becomes taxable as a result of the individual's death;
- iii. The General Component – the deceased's own assets other than jointly held assets passing by survivorship.

Consequently, it is possible that one Component may be taxed at the reduced rate while another may be taxed at the full rate.

Legacy 10 – Inheritance Tax relief for charitable giving (cont'd)

To work out whether the reduced rate of 36% applies, it is necessary to calculate whether 10% of the net relevant Component passes to charity as a result of the death.

The 10% net amount (called the 'Baseline Amount') is calculated by looking at the value of the Component at the date of death, deducting from it all exemptions and allowances relating to that Component, debts due on that Component, the relevant proportion of the Nil Rate Band (currently £325,000 that is apportioned between the Components if there are more than one), and then adding back the charity legacy due from the Component in question.

The resulting figure is the Baseline Amount and if the gift to charity is equal to or exceeds 10% of the Baseline Amount, the Component in question is taxed at the reduced rate of 36%.

You will have gathered by how technical the calculations are that, as everyone's financial situation is different, this can be a complex area. Our recommendation is that specialist advice should be sought if you want to take advantage of this opportunity.

Q – How do the changes to the nil rate band affect couples?

A – The new rules have simplified the position but have not, in fact, made a big change. The changes mean that married couples or couples in registered civil partnerships can leave their entire estates to the survivor without losing the nil rate band of £325,000 each. If the surviving partner dies, they can use the other partner's unused nil rate band, thus, in effect, as much as doubling the value of the assets that can be passed on before the people who inherit the estate need to pay Inheritance Tax. In fact, with appropriate will-planning, a similar effect could already be achieved, but the new rules make it much simpler.

Q – I jointly own my house with my sister. Can I claim the new 'double' nil rate band?

A – No. The transferable nil rate band only applies to legally married couples or couples in registered civil partnerships. If you die and leave your share in the house to your sister, she will have to pay 40% Inheritance Tax on your death if the value of your estate including your share of the house is above £325,000.

Q – Wasn't the nil rate band raised to £1 million?

A – A £1 million nil rate band was proposed at one point by the Conservative party but not enacted. The nil rate band has been held at £325,000 (although of course the survivor of a married couple/registered civil partnership may leave up to £650,000 free of tax if the first spouse or partner to die did not use up their nil rate band).

Questions and answers (cont'd)

Q – I was widowed in 1995. When I die will my estate get the benefit of the transferable nil rate band?

A – Yes. The backdating goes back indefinitely (but as noted on page 4 problems arise with respect to pre-November 1974 deaths). However, you should check if any gifts to non-exempt beneficiaries (e.g. children and friends) were made in your late spouse's will (or in the seven years before he or she died) as this would also impact on the availability of the transferable nil rate band.

Q – I've heard that there is a government initiative that will reduce the amount of Inheritance Tax that is charged to 36%. How can I benefit from this?

A – The broad aim of the relief is to incentivise charitable giving. It is part of the government's Big Society; encouraging people to play an active part in their society as part of a transfer of power from central government to community and charitable organisations.

Because everyone's financial situation is different and this can be an extremely complex area, specialist advice should be sought.

Questions and answers (cont'd)

Q – My will includes a trust. Following these changes, do I still need it?

A – If the only reason for having a trust was to utilise both spouses' nil rate band, the trust may no longer be necessary. Specialist advice should be taken because, depending on how the trust is drafted, it may be cheaper in the long run to redraft your will to remove this.

Q – If a husband has died and left the whole of his estate to his wife, but it amounted to less than the Inheritance Tax allowance in the tax year in which he died, will her estate still be able to claim the double nil rate band if she inherits from another source, or if the estate increases in value in the meantime?

A – As long as the whole of the husband's estate was left to the wife, when she dies the full £325,000 of her husband's nil rate band (if unused) can be applied to set against the total value of the estate, in addition to her own available nil rate band.

The work can continue after you've gone

Leaving a gift to charity is highly tax efficient. You can leave as much as you like to your favourite charity (or charities – there is no limit as to how many can benefit), and there will be no Inheritance Tax to pay on that amount. Put another way: you can either pay Inheritance Tax and effectively leave part of your estate to HM Government to spend as it thinks fit ... or (depending of course on whether there are family members you wish to benefit you

can make the choice to leave it to a charity that does work you care about and not have any Inheritance Tax to pay. For example, if you have organised your affairs well but you still have a potential liability for several thousand pounds of Inheritance Tax, you might choose to include a gift in your will to charity. Using the example below for a single person, a gift to charity could provide a tax saving to your estate as follows:

Estate value	£350,000	Estate value	£350,000
Value of single nil rate band	£325,000	Value of single nil rate band	£325,000
Estate value liable for IHT	£25,000	Estate value liable for IHT	£25,000
Gift to charity	£00.00	Gift to charity	£25,000
Inheritance Tax due	£10,000	Inheritance Tax due	£00.00

Instead of HM Government benefiting, your chosen charity would instead.

The work can continue after you've gone (cont'd)

How using Legacy 10 might enable people to give larger gifts to charity without reducing the amounts to include for non-exempt beneficiaries.

Example

Arthur dies on 1 August 2012 with an estate worth, before deductions, £850,000. (Assume that the Baseline Amount is £525,000.) As shown below, the availability of the reduced rate of income tax means that a 10% gift would not only increase the sum passing to charity by a massive £31,500, it would also reduce the IHT bill by the same amount. However, crucially, Arthur's non-exempt beneficiaries would still receive the same amount from his estate. This benefit would not be achieved by increasing the charity gift to less than 10%, as illustrated by the 7% calculation.

Legacy to charity	4%	7%	10%
Inheritance Tax (on £525,000 less charity legacy) at 40% or 36%	£201,600	£195,300	£170,100
Sum passing to non-exempt beneficiaries	£627,400	£617,950	£627,400
Sum passing to charities	£21,000	£36,750	£52,500

The availability of the reduced rate of IHT for gifts to charity of 10% or more has the capacity to enable people to greatly enhance the benefit to the charity of their choice without affecting legacies they wish to leave to their family and friends.

The good news

So, there are things you can be doing now to make that tax bill as small as possible, including taking advantage of the Legacy 10 initiative described on page 7.

By far the most important thing is to have a will.

If you haven't yet written a will you have no control over the way your estate is distributed when you die, and therefore no control over the amount of Inheritance Tax your estate will have to pay.

And you can choose to leave your estate to people, or to charities, where the tax is reduced or even disappears altogether.

If you already have a will, written more than a few years ago, you should think about reviewing it. It may be that your will was originally written before Inheritance Tax was likely to be a problem – and it would now be a good time to check that you are

maximising the perfectly legitimate tax breaks available to you.

We have provided a few examples of how careful planning can minimise Inheritance Tax. Individual circumstances will vary of course and specialist advice should always be sought.

What to do next

This guide is designed to help you to gain a basic understanding of Inheritance Tax, as well as to introduce you to some of the ways in which you can reduce your estate's liability.

Of course, everyone's financial situation is different, so this guide can only provide a general outline of how Inheritance Tax might affect you.

If you would like to discuss any of this in more detail, the Legacy team at PDSA would be delighted to put you in touch with a solicitor in your area.

A visit to your solicitor need not cost a great deal and it may only take an hour or so to make the whole subject clear.

PDSA, the charity that provides free veterinary care to sick and injured pets whose owners may not otherwise be able to afford it, provides free information

regarding will-making and charitable gifts. The friendly team at PDSA can discuss, in complete confidence, how to include a gift for their work in your will. This may simply entail some basic points to consider, or it may require us to provide a list of names and addresses of solicitors who could give you specific advice.

Note: This guide is based on the law that applies in Scotland as well as England and Wales.

If you live elsewhere or own assets outside Scotland or England and Wales, we recommend that you seek specialist advice.

Please feel free to telephone us on 0800 591248 between 9am and 5pm, Monday to Friday.

We will be delighted to help.

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