IHT PLANNING AND PROPERTY: TIPS TO MINIMISE TAX BEFORE AND AFTER INHERITANCE

COMPLIMENTARY GUIDE

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WHY ADVICE ON
INHERITING PROPERTY IS VITAL

House prices have been rocketing, particularly in property hot-spots like London and the South East. The property boom means that more and more people are inheriting a family home worth several hundreds of thousands of pounds at around the time they are retiring and their children are flying the nest.

This is a situation that frequently comes up in our conversations with users of our service and often serves as the trigger point for people to seek professional wealth management advice for the first time – particularly if there are other complicating financial factors in view.

Over 2015, a fifth of our users described themselves as having received a large amount of money or other assets like property, and a third wanted help with retirement planning. We often speak to users in their fifties and sixties who have inherited a property and are seeking advice on what they should do with sums of around £250,000 and up – perhaps not enough to retire on, but certainly a large chunk of money which could mean a big boost to their lifestyle long term, if managed well.

But the property boom also means that many people may have been sleepwalking into leaving their beneficiaries with a hefty Inheritance Tax bill when they pass on. While property prices have been increasing meteorically, the Inheritance Tax threshold has not risen by anything like the same magnitude, nor at the same pace. Much was made of the government's recent move to raise the IHT threshold to £500,000 per person and so enable spouses or civil partners to effectively gift £1m to children or grandchildren tax-free. Yet this change doesn't fully come into effect until 2020.

Today, the IHT threshold remains frozen at £325,000 per person – with anything above that subject to a punitive 40% tax. Even those who consider themselves only moderately affluent are likely to have their estate caught by the IHT net once a house and even modest savings are taken into account.

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The good news is that there are lots of strategies wealth managers and lawyers can advise you on to help, both before and after inheriting a property. Some are well known and quite simple, but others require more expertise to deploy. The key to most of them however is the same - and that is to start thinking about things sooner rather than later.

In this guide we partner with national law firm Weightmans to outline essential steps to take both before and after inheriting property. We hope this guide helps further your financial goals.

– LEE GOGGIN,
CO-FOUNDER
findaWEALTHMANAGER.com

With more families facing inheritance tax (IHT) bills, findaWEALTHMANAGER.com has given tips to help minimise your estate's exposure to the tax.

ESSENTIAL ACTION
BEFORE AND AFTER INHERITING PROPERTY

Paul Horton, Partner, and Shahida Jogi, Associate Solicitor, at national law firm Weightmans explain essential action for affluent individuals to take before and after inheriting property.

In 2012-13, approximately 3% of all deaths led to an Inheritance Tax charge. Residential property made up 35% of the total tax-paying estates.

There are many issues that may arise when residential property forms part of a deceased's estate and in turn manifold possible impacts on individuals' IHT liabilities. There are also other possibilities to consider to pass on family wealth in a more tax-efficient manner, not just residential property.

IHT receipts to the Treasury have risen by 11.9% compared to 2013-14, and were around £3.8bn in 2014-15. The level of receipts has been affected by the freeze on the nil rate band at £325,000 since April 2009 and the general increase in the value of, in particular, residential property.

The average IHT due per taxpayer was £236,000 in London and £176,000 in the South East of England, as compared to £120,000 in Wales and £134,000 in the North West of England. This is, at least in part, because of the higher residential property prices found in the first two regions.

WHEN IS IHT PAYABLE?

The main occasions when IHT becomes payable:

- On death – when someone dies, IHT is paid on the net value of an estate (assets less deductible liabilities) where the net value exceeds the nil rate band;
- Gifts made by one individual to another, where the donor does not survive seven years after making the gift are added to the net value of an estate;
- Gifts into discretionary or other relevant property trusts (see further below).

These three points illustrate that although the most common trigger for the charge to IHT is on death, IHT can also be charged on lifetime gifts. This is a fact all too often under-appreciated by clients when undertaking IHT planning.

HOW MUCH IHT IS PAYABLE?

The rates of tax differ. On death, the net estate up to the value of the nil rate band is charged at 0% (i.e. there is no IHT to pay). However, an estate valued above the NRB is taxed at 40%.

Lifetime IHT is charged at 20%. A typical example of when this charge might arise is when substantial gifts are made to a discretionary trust and the value of that gift is not covered by the available nil rate bands, or particular reliefs to IHT.

IHT EXEMPTIONS
AND RELIEFS

Affluent individuals need to know that there are various exemptions and reliefs available to reduce a liability to IHT.

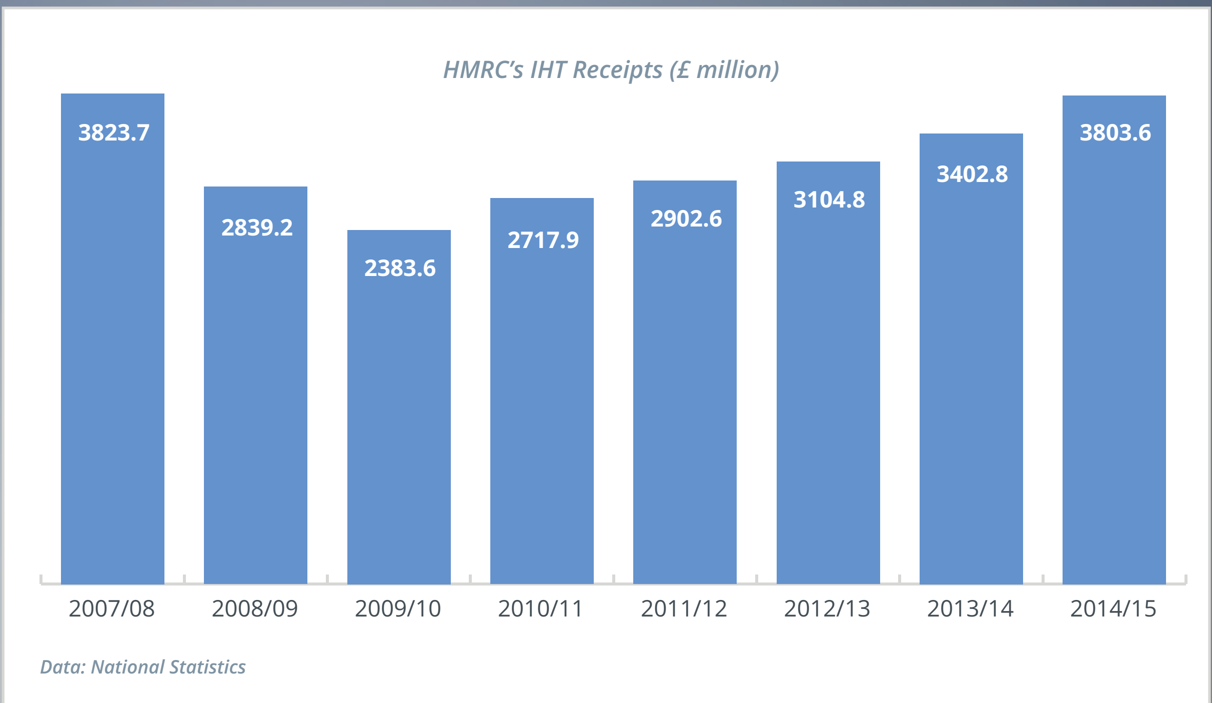
There is a special exemption for married couples whereby, if the whole of an estate passes to a surviving spouse on death, no IHT is payable (this is often referred to as the spouse exemption). In addition, special rules (known as the transferable nil rate band) allow married couples to aggregate their individual allowances so that the survivor spouse could have £650,000 (£325,000 x2) to offset against the value of their own estate. From April 2017 an additional residence nil rate band will be introduced starting at £100,000 and rising up to £175,000 in 2020/2021. This residence nil rate band is linked to the value of the main residential property in an estate and similar rules we will apply in connection with married couples and the NRB.

Gifts between spouses during their lifetime also benefit from the spouse exemption.

Lifetime gifts that are part of normal expenditure from net (after tax) income are exempt from IHT. There must be a regular pattern to the gifts, they must be made without resorting to capital and while maintaining the existing standard of living.

Other exemptions are an annual exemption for gifts under £3,000 and a separate exemption for small annual gifts up to the value of £250.

Business Property Relief and agricultural property relief are very valuable if there are qualifying assets. These reliefs operate to potentially remove from the IHT regime entirely interests in privately-owned trading companies, partnerships and farms. The reliefs in both cases are complex but can, if available, provide significant IHT planning opportunities. Ask your wealth manager about the possibility of including investments like the Enterprise Investment Scheme in your portfolio if reducing IHT is on your mind. You should not undertake tax-efficient investing without proper advice.



INHERITING **PROPERTY**

Property can be inherited following the death of the owner via a will (or the intestacy rules if there is no will) or can be the subject of a gift during someone's lifetime. If the property forms part of a deceased's estate, a grant of representation issued by the court will usually be required by the Land Registry to transfer the legal title of the property to the beneficiaries. The executor of the estate will need to obtain a grant of probate (if the deceased left a will). If there was no will a legal representative of the estate should apply for a grant of letters of administration.

Beneficiaries who inherit from an estate may consider entering into a Deed of Variation following an individual's death to re-distribute their inheritance – perhaps to their own children or to a trust for their benefit. A Deed of Variation has IHT advantages for that beneficiary.

However, to be valid, and so qualify for those tax advantages, a Deed of Variation must be completed within two years of the death and cannot be made in return for a payment.

Again, Deeds of Variation are complex and specialist advice should be obtained to ensure that it is drawn up properly and does not give rise to unexpected tax consequences.

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JOINTLY-OWNED **PROPERTY**

Let's take a typical scenario. A husband and wife (or registered Civil Partners) own their home together. Both their names are on the title deeds.

As co-owners they may hold the legal title as joint tenants. This means that they both own the whole of the property and on the death of one, the property automatically passes to the survivor, regardless of whether the deceased partner left a will. The Land Registry must be notified of the death so that the records are updated to show the survivor as the sole owner. This application is very straightforward and only requires production of the death certificate as supporting documentation.

Co-owners can also own property jointly as tenants in common. Again, both of their names would be stated on the title deeds. Each party would each own a distinct share of the property. The parties may own equal or unequal shares in the property. Say two people bought and lived in a property together but one contributed a greater portion of the deposit, 80%, and therefore owned a greater proportion of the property consistent with their contribution. The Land Registry records would show they both own the property, but not elaborate in what proportions.

In these cases, a separate declaration of trust, usually drawn up by the conveyancing solicitor, would be required to specify that one person owned 80% of the property and the other 20%. Without this, the assumption would be that both owned an equal half share and this could have unintended consequences for any future dealings, particularly on separation or death. If the property is owned as tenants in common, on death the deceased's share would not automatically pass to the survivor as it does with joint tenants. Instead, the deceased's share would pass according to the terms of their will (if there is one) or the rules of intestacy in the absence of a will and a grant of representation would be required to effect transfer of the legal title.

MAKING A WILL/ ESTATE PLANNING

It is important to prepare a will if you own property jointly with someone else, particularly if it is owned as tenants in common to clearly state who would inherit your share on your death. As well as considering who might own the property on your death, if there is more than one beneficiary, what about their relationship with the future co-owner(s)? Will they be able to make decisions about the property together? If they cannot agree, how would any conflicts be resolved?

For many people, their property is their most valuable asset and most people wish to endeavour to ring-fence the value of this asset from potential IHT charges so that they can pass as much of their estate as possible to their loved ones.

Individuals can plan for the financial future of their loved ones by implementing tax-effective strategies to ensure that family wealth is passed down using available exemptions and reliefs, and that liability to IHT is reduced as far as possible. Specialist advice is always needed, however.

TRUSTS

The use of trust can be a very effective strategy. Trusts can be set up during your lifetime or following your death through your will. They can accept assets including cash or residential property, which will then be sheltered from personal taxation. They can be used to provide for various family members and common uses have been to pay for education of children or grandchildren, or to purchase property for future generations.

Trusts are the favoured mechanism to pass wealth to the next generation while retaining some control over how and when they should benefit. Discretionary trusts are a very popular type of trust for this purpose, but they are subject to their own IHT regime which means that:

- broadly speaking, assets (unless covered by business or agricultural property reliefs) transferred into the trust in excess of £325,000 (individual) or £650,000 (married couple or registered civil partners) are subject to IHT at 20%;
- there is a 10-year anniversary charge of 6% upon the assets in the trust;
- there is an exit charge when assets leave the trust, being a proportion of the anniversary charge; and
- Rates of income tax and capital gains tax tend to be at the highest rates if incurred by the trustees.

However, assets held in a discretionary trust benefit from the advantage of being held outside an individual beneficiary's estate. Therefore, the value of the Discretionary trust does not form part of their estate on death, thus helping to reduce exposure to IHT at 40%. The use of residential property, particular your main residence, to create a trust is a complex area and may not succeed in removing the value of the asset from your estate for IHT purposes. Specialist advice should be obtained before undertaking such planning.

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FAMILY INVESTMENT **COMPANIES**

Individuals or couples who wish to pass substantial wealth to the next generation and where trusts or outright gifts are not appropriate can consider alternative structures such as a "family investment company" - a UK registered company, the shares of which are held by the family. This structure can be extremely useful for cash assets. However its use where the main assets to pass are property are more limited due to the potential exposure to capital gains tax when property increases in value.

The main benefits of a family investment company are that:

- there is no IHT entry charge when cash assets are transferred to the company;
- the company pays corporation tax at the rate of 20% (19% from 2017) on the profits it makes;
- most dividends received by the company are exempt from corporation tax; and
- the shareholders (the family) only pay tax if the company makes distributions to them which means that while profits are retained by the company there is no tax for them to pay.

The transfer of cash assets to the company is a potentially exempt transfer which means that for the donor there are no IHT consequences provided he or she survives the gift to the company by seven years.

There are drawbacks to family investment companies which include:

- a CGT for the donor if non-cash assets i.e. property are transferred to the company – the rate of CGT upon the gain is currently 20% and
- double taxation on the profits made by the company.

A family investment company will be attractive while the difference between corporate and personal tax rates remains, albeit not necessarily for non-cash assets. Furthermore, a trust may still be the most appropriate structure for those assets that qualify for a relief from IHT (such as Agricultural or Business Property relief) as there will be no IHT or CGT to pay if those assets are transferred to a trust.

This article concerns the law as at 1 July 2016 but it does not provide a full analysis of those matters with which it deals and is provided for general information purposes only. It is not intended to constitute legal advice and should not be treated as a substitute for such advice. Weightmans LLP accepts no responsibility for any loss that may arise from reliance on the information in this article.

SUMMARY

IN **SUMMARY**

In order to mitigate any potential IHT in your estate and ensure your estate passes to your loved ones, you should undertake careful estate planning and make a will. Every estate and individuals' affairs are different and a solicitor can provide specialist advice in this area.

If you do not have a will, the rules of intestacy will dictate how your estate is divided up and this may not be in accordance with your wishes. The best course of action is to make a will and ensure that this is regularly reviewed, at least every three to five years, to ensure that it meets with your current wishes.

ABOUT **WEIGHTMANS**

Weightmans LLP is a Top 45 law national firm. The Wills, Tax, Trusts and Probate Team offer bespoke wills and tax planning advice for all clients, particularly those of a high net worth.

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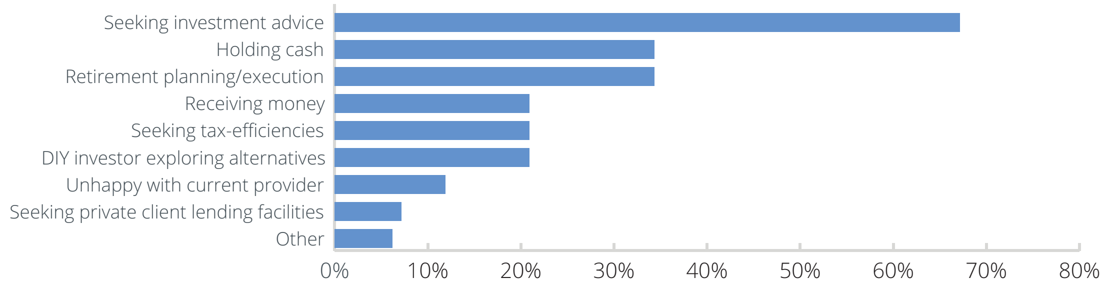
Reasons users of findaWEALTHMANAGER.com are seeking a wealth manager



NEXT **STEPS:**

While there is a lot that can be done to mitigate IHT, you should always take professional advice before making any significant decisions.

The wealth managers accessible through findaWEALTHMANAGER.com have deep expertise in financial planning matters such as estate planning and tax-efficient investing. They often advise the affluent individuals using our service when they have inherited property and would be pleased to offer a no-obligation discussion at a time to suit you.

To start the process of finding the best wealth managers for your profile and needs, simply take **our short, free assessment.**

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