

Basic IHT planning points

Synopsis: With the nil rate band frozen at £325,000, are your clients taking advantage of the inheritance tax planning options available to them?

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Historically, it was common for the inheritance tax (IHT) nil rate band to increase on an annual basis. However, since 2009/10 it has been capped at £325,000 and will remain at this level until 2025/26.

Further, HMRC's latest IHT statistics have shown that receipts have been increasing so this may provide an opportunity to engage with clients to see what planning options they may wish to take advantage of.

Use IHT exemptions

The starting point for anyone who is wishing to carry out IHT planning is to use their exemptions - the most common ones being...

- Annual exemption – each individual can give away £3,000 each year, and use the previous year's exemption if not already used.
- Small gifts exemption – up to £250 can be given to any number of individuals (note this exemption cannot be combined with any other exemption in favour of the same person).
- Normal expenditure out of income – gifts can be made out of surplus income provided the gift does not affect the donor's usual standard of living.

Planning in this area is often overlooked with few clients using these exemptions to the full potential – even though, over time, regular use of these exemptions can result in significant IHT savings. Take the example of someone who has made use of their annual exemption over say 15 years – £45,000 would have been gifted free of IHT, saving £18,000 in tax!

Lifetime planning

In some cases, it may be possible for your clients to make other lifetime gifts, whether outright to another individual or by executing a trust.

The current regime for outright gifts (including gifts to bare trusts) is favourable, thereby providing scope for lifetime planning.

Outright gifts are 'potentially exempt transfers' (PETs) for IHT, meaning that no lifetime tax is payable on the gifted amount, or on any increase in value if the donor survives for the required seven-year period. Also, there is no limitation on such gifts or on the amounts which can be gifted. So provided the donor is in reasonable health and is happy to make such gifts, substantial IHT savings can be made.

In cases where an outright gift is not a suitable option, a trust (other than a bare trust) can be used.

Today, most forms of trusts where the client wishes to maintain control of the assets are taxed as relevant property trusts and so are subject to the discretionary trust tax regime. Because the trust fund does not vest in anyone's estate for IHT purposes, associated IHT charges apply on creation, when capital is appointed out of trust and on each ten-year anniversary. These are more commonly known as an entry, exit and periodic charge. And in some cases, reporting obligations may also need to be fulfilled.

There are also a number of other types of trust widely available for IHT planning purposes, which can be used where the client can retain access if they require, for example a gift and loan trust, a loan trust and a discounted gift and income trust. Advice should be sought to determine which (if any) of these options are likely to be suitable.

Deeds of variation

Where assets are inherited, whether under a will or under the intestacy rules, it is possible to redirect the inheritance to achieve an immediate IHT saving by using a deed of variation.

Ordinarily, the inherited assets will accumulate in the taxable estate of the receiving beneficiary who may not want or need the inheritance. Instead of choosing to make a gift of the inheritance (which would either be treated as a PET or a chargeable lifetime transfer), it is possible for someone to take advantage of the deed of variation option and achieve an immediate IHT saving on their own estate.

To achieve the desired outcome, the variation must...

- Be in writing.
- Contain a statement that the relevant legislation (s142 IHTA 1984) is intended to apply.
- Be made within two years of death by the person(s) who would have benefitted from the original gift.
- The property must have been included in the deceased's estate at the date of death.

In practice, there is no requirement to vary the entire amount of the inheritance enabling the client to choose to vary only part of it. It is possible to vary an amount directly to an individual or to a trust. The option chosen will of course depend on the client's specific circumstances taking account of factors such as whether they are wealthy in their own right, whether they are likely to want to retain control and whether they may wish to benefit in future should the need arise.

A variation into a discretionary trust enables the client to retain access by being named as a beneficiary. They can also maintain control by acting as one of the trustees. This is a viable planning option which does not fall foul of the gift with reservation provisions or pre-owned assets tax – the variation is effectively treated as having been made by the deceased for IHT purposes provided the necessary conditions are satisfied.

Note, in cases where the variation is into trust and the client is included as a beneficiary, they will be taxable on any income arising within the trust under the settlor-interested trust provisions.

This technical paper provides a general overview of some of the IHT planning options available. In practice, each client's objectives and circumstances will need to be borne in mind, forming the basis of any advice which is given.

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