Saga MAGAZINE

Taming Inheritance Tax

Inheritance Tax (IHT) is one of the most controversial taxes in the UK. **Taming Inheritance Tax explains how to work out** whether IHT will be due on your home and possessions when you die; how much your heirs are likely to pay; how much you can give away before you die; and how to reduce the amount of tax that is due.

About this guide

There are now no differences in the way tax law treats men and women. It also treats married couples identically to civil partners of the same sex. So in this leaflet the word 'marriage' includes same sex civil partnerships and the phrase 'married couple' includes a same sex couple who are civil partners and the word 'spouse' includes civil partner. Also 'widow' includes widowers and bereaved civil partners. And when I write 'she' I could just as well write 'he' and vice versa. **Note** that couples who are not married and not in a civil partnership are treated like two single individuals.

This leaflet gives general guidance only. It should not be relied on for major decisions on property or tax. You should consult a qualified accountant, tax adviser or lawyer before taking action on the basis of the information in this leaflet. But once you have read it you will be in a much better position to have those discussions with the professionals.

Taming Inheritance Tax was written for Saga Magazine by freelance financial journalist Paul Lewis. Neither Paul Lewis nor Saga Publishing accepts any liability from any use made of the information contained in it.

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INTRODUCTION

By Paul Lewis

Saga Magazine's money expert

No one enjoys paying tax. But Inheritance Tax, or IHT, seems to be hated more than any other. People have worked hard for their money, their home or their property and many believe they should be free to pass these possessions on to their heirs in full without the state taking a slice. The next generation often feels that the property of their parents – particularly the 'family' home – is somehow theirs and that taxing it is tantamount to theft, especially if they fear that the home will have to be sold to pay the tax.

Anxiety about this most hated tax grew as rising house prices drove up the number of estates liable to IHT from around 18,000 each year in the 1990s to a peak of 34,000 estates in 2006/07. But the number fell back to a low of 15,000 in 2008/09 mainly because the threshold at which the tax begins was doubled from 9 October 2007 for most people who were widowed. Since then numbers have drifted up slightly. HM Revenue & Customs estimates that 20,000 estates will pay IHT in 2011/12. But that is still a very small percentage.

In 2010 more than 550,000 people died in the UK but in 2010/11 only 17,000 estates paid IHT. That is 3% of those who died. In other words, for every 100 people who died in 2010 no IHT was due from the heirs of 97 of them. Some of those estates were exempt because a spouse or civil partner inherited the whole estate free of IHT.

But anxiety about IHT remains. For most people their most valuable possession is their home and the value of the average home has risen far more rapidly than the increase in the threshold at which IHT begins. If the IHT threshold had gone up in line with house prices since 1996/97 it would be £620,000 in 2012/13 instead of £325,000. Although the current threshold is around twice the average price of a home in the UK, in some parts of the country many, if not most, homes are still worth more than £325,000. That leaves homeowners in those areas fearing that their estate will be liable to IHT when they die.

Of course, IHT is due on the whole value of what you leave not just your home, but for most people it is the value of their dwelling that drags their estate into the IHT net.

The strength of feeling about Inheritance Tax was shown in September 2007 when the then Conservative shadow chancellor George Osborne promised his party conference that the next Conservative government would raise the threshold at which IHT begins to £1 million. That simple promise was widely credited with giving the Conservatives a clear lead over Labour in the opinion polls and derailing Labour's plans for an election that year.

In response Labour's chancellor Alistair Darling introduced a complex but expensive change in the rules that would remove the fear of IHT from most families headed by a married couple or civil partners. For their heirs the threshold at which the tax begins has effectively been doubled. The result was to relieve thousands of estates from IHT and reduce the amount the tax brings in by £1 billion a year. In its last budget before the 2010 general election the Labour government cancelled a planned rise in the threshold and froze it at £325,000 until 2014/15.

That freeze was confirmed by George Osborne, the chancellor of the new Coalition Government, in his first budget in June 2010.

WILL MY ESTATE BE LIABLE TO IHT?

To see whether your estate will be liable to Inheritance Tax when you die, add up the value of everything you own, including your house, any investments, savings, personal property, and the value of any life insurance policies which form part of your estate (see *Life Insurance* on page 15 on how to avoid IHT on these). Then add on any gifts you have made in the past seven years (except gifts that are exempt – see *Reducing Inheritance Tax* on page 12). From this total, take away any debts. These include a mortgage or equity release debt, any other loan secured on your home, any money you owe on credit cards, any personal loans or hire purchase agreements, and any unpaid bills, including any income tax you may owe. You can also deduct the reasonable costs of your funeral. Finally deduct the amount you intend to leave to charity. Once you have worked out the final total of your estate, the next step depends on your marital status.

Single – **anyone who is not married at the time they die. That includes divorced people and civil partners whose partnership has been dissolved by the courts.** If your total estate is worth £325,000 or less then no tax will be due. If it is more than that, it is likely there will be IHT to pay.

Couples – **who are married or civil partners (and remain so when the first dies).** If the first to die leaves everything to their spouse, **which is now the recommended advice in almost all circumstances**, then the whole estate is completely free of IHT. When the second member of the couple dies, there will be no tax to pay if the total is £650,000 or less. If your total is more than that, it is likely that there will be IHT to pay by your heirs when the second spouse dies.

Widowed – **someone whose spouse or civil partner is already dead.** The tax-free amount depends on what the first to die left on their death. If everything was left to their spouse then no tax will normally be due on the first £650,000 when the widow dies. If the late spouse left money or property to someone apart from the surviving spouse, then the widow will be able to leave at least £325,000 and up to £650,000 to her heirs with no tax due.

The rules affecting couples and widows are explained in more detail later.

HOW MUCH TAX?

The IHT threshold normally changes on 6 April each year (though that was not always so in the past). However, it has now been frozen until the tax year 2014/15. So the thresholds of £325,000 or £650,000 apply to deaths from 6 April 2009 to 5 April 2015. Strictly speaking the 'threshold' is called the 'nil-rate band', because on that band of the value of the estate the rate of tax is nil. It can also be called an 'allowance' – as you are 'allowed' to leave that much before tax is due.

Table 1
Thresholds for Inheritance Tax

	Single	Married couple when second spouse dies
2009/10 to 2014/15	£325,000	Up to £650,000

The rate was confirmed in the budget in June 2010.

The rate of IHT is 40% of the excess above the threshold. To work out the tax due subtract the threshold from the value of the estate and multiply the answer by 0.4.

For example: *Mary is single. When she dies she will leave her estate to her nieces. She reckons that after her debts and funeral are settled it will be worth £425,000. To work out the tax that will be due she takes the threshold from the total which is £425,000 - £325,000 = £100,000. And then works out the tax as £100,000 x 0.4 = £40,000. That leaves £385,000 to be divided between her nieces.*

For example: *Martha inherited everything from her husband Pierre when he died. Her estate would come to £800,000. So she can subtract twice the current threshold of £325,000. She works out £800,000 - £650,000 = £150,000 and then multiplies that by 0.4 to get £60,000 as the tax her heirs will have to pay.*

Table 2 gives some examples of the tax due on estates of various sizes for single people and on the second death in a couple where the widow inherited all her late spouse's property.

Table 2
Tax due 2009/10

Estate value	Single*	% of total	Widow**	% of total
£325,000	£0	0%	£0	0%
£375,000	£20,000	5%	£0	0%
£425,000	£40,000	9%	£0	0%
£500,000	£70,000	14%	£0	0%
£650,000	£130,000	20%	£0	0%
£750,000	£170,000	23%	£40,000	5%
£1,000,000	£270,000	27%	£140,000	14%
£1,500,000	£470,000	31%	£340,000	23%
£2,000,000	£670,000	34%	£540,000	27%
£3,000,000	£1,070,000	36%	£940,000	31%

** includes surviving spouse where the first to die in a couple left items to someone other than spouse*
*** who was left the whole of the estate by her late spouse*

COUPLES

Husbands and wives (and registered civil partners) do not have to pay any Inheritance Tax on money or property left to them by their spouse. And the new rules for couples mean it is usually best for them to leave everything to each other.

Everyone can leave up to £325,000 free of IHT. In addition a spouse can leave all that they own tax-free to their spouse. In the past if they did that they wasted their own tax-free allowance as their spouse just had the same £325,000 allowance when they died. But that changed on 9 October 2007. From that date a widow has a threshold consisting of her own £325,000 allowance **plus** any unused part of the allowance of her late spouse, whenever he died. So if the late spouse left nothing to anyone else, the widow has a double allowance when she dies.

The new rules began on 9 October 2007 and apply to

- **All married couples and civil partners from that date**
- **All widows alive on that date who were widowed before that date**

They do not apply to couples where both had died before 9 October 2007.

If the first to die leaves everything to their spouse then the rule is easy. When the widow dies her estate gets a double allowance at the rate current at her death. So if a widow dies in 2012/13 and she inherited everything from her spouse then her estate gets an allowance of 2 x £325,000 = £650,000.

If the first to die does not leave everything to their spouse then the arithmetic is more complex. If he used half his allowance then half of it is left and his widow's estate gets half the allowance current at **her** death. So this year she would get her own allowance of £325,000 plus another £325,000 ÷ 2 = £162,500 making a total of £487,500.

Whatever proportion of her late husband's allowance was unused, she gets that proportion of the allowance which is current at her death.

The formal way of doing the calculation is as follows

- **Add up everything the first spouse left to people other than his wife.**
- **Subtract that from the allowance current at the time of his death.**
- **Divide the answer by the total allowance at the time of his death.**
- **Calculate the same proportion of the allowance current at the time of the second death.**
- **Add that to the full allowance current at the time of the second death**

For example: *Hester and Peter were married for 30 years. Peter got cancer and died in May 2005. Before his death Peter and Hester discussed Inheritance Tax and decided that he would leave the house to Hester and £55,000 in cash to their two children, Annie and Charles. That way they got the £55,000 free of IHT and Hester could manage without the income it brought. Hester is now ill herself with just a few months to live. If she dies in September 2013 the IHT allowance will be £325,000. Her home, contents and other possessions are worth about £550,000. Hester lives on her pensions and has little else of value. Under the old rules Hester's estate would have been £225,000 over the IHT threshold and tax of £90,000 would be due. Under the new rules Hester's executors can look back to Peter's death to see if Hester can add his allowance to hers. At the time he died the IHT threshold was £275,000. He left £55,000 to his children which used up 20% of that allowance. So Hester's estate can claim 80% of the allowance current at her death — 80% of £325,000 is £260,000. That is added to the standard £325,000 to give a total allowance of £585,600. That is above the value of the estate so no tax is due.*

Deaths before Inheritance Tax began

Inheritance Tax began on 18 March 1986. For first deaths back to 13 March 1975 the calculation is straightforward. The previous Capital Transfer Tax (CTT) also had a nil rate band and allowed spouses to leave any amount to each other free of tax. So the calculation is exactly the same when the first death was under the CTT regime.

For example: *James Golding died in June 1980. He left everything to his wife Marigold except £5,000 which he left to his two sons Mark and Rufus. At that time the tax-free allowance for Capital Transfer Tax was £50,000. So James did not use £45,000 of the allowance. £45,000 ÷ £50,000 = 90%. So when Marigold dies she will be able to have 90% of the current allowance. If she dies now her estate would have her full allowance of £325,000 and another 90% of that allowance which is £292,500 making a total of £617,500. If her estate was less than that amount her heirs would pay no IHT.*

The thresholds for IHT and CTT back to 1975 are listed in Appendix 1. For deaths before the introduction of CTT on 13 March 1975 the calculation is a little trickier. It is explained in Appendix 1 together with the allowances to use for deaths back to 1914. In such cases it is sensible to ask for help from HM Revenue & Customs Inheritance Tax and Probate helpline on 0845 302 0900 or 0115 974 3009 to make sure that you have got the calculation right.

Second marriages

Someone who has been widowed more than once can carry forward allowances from more than one husband. However, she cannot accumulate an allowance of more than 100%.

For example: *Mary was widowed in her thirties when Sam died in a road accident in 1978. He had left £10,000 to his sister and the rest to Mary. At the time the CTT allowance was £25,000 so he used 40% of it and that left 60% to be inherited by Mary. She remarried and sadly her second husband Kurt died in July 1995. He had children from a previous marriage and left them £77,000. That used half of the £154,000 allowance current at the time, leaving 50% to be used by Mary. When Mary dies her heirs will be able to look back to both these past husbands and bring forward 60% from Sam and 50% from Kurt. That would make 110% but she can only inherit a maximum of 100%. So her heirs can count her own allowance and another full allowance at the time of her death. If she died now that would make an allowance of £650,000.*

Evidence

The new rules mean that exactly what was left in an estate in the past has become an important factor in working out the allowance due on a widow's estate. Evidence for these past events may be difficult to find as family papers will often have been destroyed, especially if the first death was many years ago. Estates where no tax was due did not have to be notified to the Revenue and normally no official records exist. That can be true even if there was a will if the estate was below the IHT threshold and especially if all the property was left to the spouse.

On larger estates, with or without a will, probate or administration would be granted and once that happens the will administration documents become public for anyone to see. So if the deceased left a will on which probate was granted then a copy of it can be obtained through the court system for a small charge. Contact the Probate Registry in England and Wales, the local Sheriff Court or National Archives in Scotland and the Public Record Office in Northern Ireland. See *Further Information* on page 20 for how to contact them.

If the deceased did not leave a will then the details of who inherited may also be available from probate records if the estate was large. Alternatively a lawyer who dealt with the estate may have kept the papers, though after long periods of time they may have been destroyed. If there is no indication of who inherited property then you should assume it all went to the spouse. Before 13 November 1974 it was common for a spouse to be left only a life interest in the property rather than inheriting the property itself. If she did inherit only a life interest then when she dies the whole estate may be exempt from IHT under special rules, which are explained later (see *Older Widows,* page 16).

No need to split home ownership

The changes to the law in October 2007 reverse almost all the advice given to couples about how to reduce inheritance tax. There is no longer any need to split the ownership of the family home between husband and wife or for each to leave their half to their children. There is no longer any need to set up a trust – the so-called 'nil-rate band trusts' – to leave your heirs property up to the value of the IHT allowance at your death. All these schemes were intended to make sure the first to die used their IHT allowance. But they are unnecessary now that the first to die can pass on their allowance to be used when their spouse dies.

Now the advice to married couples and civil partners in almost all circumstances is for each to leave everything to their spouse. That will ensure that when the second partner dies their heirs will benefit from double the current IHT allowance. Of course, if the value of the estate grows more rapidly than the rise in the IHT allowance, then eventually the tax due may be greater when the second dies. That may happen eventually if house prices begin to rise and the Inheritance Tax threshold remains frozen. But the alternative is complex and is not normally worth considering.

Spouses who have already split their property or set up a nil-rate band trust should rewrite their wills to leave everything to their spouse. There is no need to change again the way the home is owned. Where one spouse has already died the will can be rewritten within two years of the death as long as all the heirs agree. It is called a Deed of Variation and making one would be the sensible course in most cases. Where the first spouse died more than two years ago it is not possible to rewrite the will and nothing can be done. The old arrangements – which were sensible when they were taken out – will have to stand.

There is one main exception to the general rule that spouses should leave everything to each other. If a widowed woman has married again and she will inherit a full allowance from her first husband, then it is sensible for the second husband to leave up to his own nil-rate band to his children or other heirs. On his death they will inherit, say, £325,000 of property tax-free. Then on their mother's death they will benefit both from her IHT allowance and the one inherited from her first husband. So people married to someone who has been widowed should consider this option when planning their tax. It may be that splitting property and nil-rate band trusts are not quite dead yet! If this might apply to you, the details of what to do are set out in *Appendix 2* on page 25.

There are other circumstances, unrelated to IHT, in which a spouse may want to leave property to other people. For example, someone who has married again might want to leave property to children from their first marriage, rather than to their second spouse. In some cases that can be done through a trust so that the second spouse can, for example, continue to live the couple's home but on her death it will pass to the first spouse's children. In such cases you should see a lawyer.

Unmarried couples

The new rules apply to couples who are married or in a civil partnership. Unmarried couples are not helped by them as they are treated as two single people when IHT is worked out. From an Inheritance Tax point of view, an unmarried couple should marry or form a civil partnership.

If they do and have children together then the children will eventually benefit from the double IHT allowance. If they have children from previous relationships then they can leave up to £325,000 to them and the balance to their new spouse with no IHT to pay.

It does not matter how late the marriage occurs – it can be on the death-bed as long as it is a valid marriage and a new will is made leaving everything to the spouse.

If you want to get married quickly if one partner is seriously ill, contact your local registrar and explain the circumstances. Normally at least 14 days' notice has to be given but that can be reduced and the normal provision that you must marry in 'approved premises' can be waived.

Except in Scotland, a marriage or civil partnership will render invalid any existing will so each spouse will need to make a new will. The only exception is if the will is made 'in anticipation of marriage' to the person whom they do then marry. To make a will a person must be mentally capable of doing so.

Other people who may have expected to inherit may be unhappy at such rushed arrangements. If there is a substantial amount of money involved they may challenge the changes in court. But recent cases in England indicate that if all is done according to the law and all parties had the mental capacity to marry and make a will then the courts will reject such challenge although disinherited children might have a claim under the Inheritance (Provision for Dependants) Act. However, in Scotland such a will could be successfully challenged if it does not make adequate provision for children of the deceased.

Of course, not all people who live together can marry – two close relatives for example or two people where one is still married to someone else. They should consider their IHT options carefully. First, be aware that you can leave only £325,000 before IHT is due. And that includes leaving money or a share of your home to your partner. If the person who died owned the home, then IHT may be due if it is worth more than £325,000. Even if the home is owned jointly, if it is worth more than twice the IHT allowance then tax could be due on the first death as a half share of it alone would be more than £325,000.

For example: *Hamish and Fiona have lived together since the 1970s and saw no reason why they should get married. They have no children. Their home in London – modest when they bought it – is now worth £900,000. They own it between them. When Hamish died this year his estate was half the value of the house plus some savings – which are his rather than theirs – making a total of £525,000. His allowance is £325,000 so Fiona would have to pay IHT on the difference of £200,000 which at 40% would cost her £80,000. That is far more than his savings and she does not know where she will get the difference of £30,000. She fears she might have to sell their home to pay the tax. If Hamish and Fiona had married just before his death and made wills she could have inherited everything tax free.*

The Revenue will allow any IHT due on property to be paid off over ten years. If Fiona applies for that concession she will have to find £3,000 a year and interest will be charged on the outstanding amount at 3% a year.

A recent law in Scotland gives unmarried couples some rights to each other's property on death or separation. But they make no change to the IHT rules. The Law Commission has suggested similar changes in the law in England and Wales. But these proposals do not include changes to Inheritance Tax law and it seems unlikely that such a change will be made.

REDUCING INHERITANCE TAX

There are several ways to reduce the amount of IHT that is due.

Live seven years

Anything you give away at least seven years before your death is completely exempt from Inheritance Tax. So if you are healthy and you have substantial assets and you start giving them away in, say, your fifties or sixties, then as long as you live seven years from the date of the gift, no IHT will be due on that money. Technically these are called Potentially Exempt Transfers or PETs as they are exempt only if you live another seven years.

But, and there is a big but here, if you give something away and continue to use it then it is still counted as part of your estate. For example you might give your daughter a valuable painting but she lets you keep it hanging on your wall. A present like that is called a 'gift with reservation of benefit' or GROB. And it counts as yours, not hers, when your estate is taxed.

This rule applies equally to your home. So if you give your home to your children but you continue to live in it then it is counted as your property, not theirs, when you die. In theory it is possible for you to live in the home without getting any 'benefit' from it if you pay your children a market rent. But they would then have to pay income tax on the profit from the rent and they would also have to pay capital gains tax on the rise in value of the home from when you make the gift to the time you die. So it is seldom a good idea.

There is one exception to this rule. If you give your home away to a relative, move out, but then have to move back either due to unforeseen circumstances or because you are unable to maintain yourself due to old age or infirmity, then its value may not form part of your estate. This rule is complicated and the Revenue will look carefully at any claims that make use of it.

There is another problem with giving things away. If you give away an object or an investment which is now much more valuable than when you acquired it – perhaps some shares you bought in the 1960s – then you may have to pay Capital Gains Tax on the growth in its value. When you give it away, the tax is calculated as if you had sold it at market price on that date. So it is much simpler to give away cash.

If the gifts you make in the seven years before you die total less than the nil-rate band (threshold) when you die, then they are simply added onto your estate and tax is calculated on the whole amount. The people who have received the gifts have no responsibility to pay any of the tax due. It all comes out of the remaining estate.

However, if you make gifts within the seven years before your death and their total value is more than the nil-rate band (threshold) when you die, then tax will be due on the gifts – or some of them – and normally that will be paid by the recipient. If you are in this position – either as the donor or the recipient – see *Appendix 3* on page 27 for a guide to these rules.

Exempt Lifetime Gifts

Each year you can give away a certain amount and it will be exempt from Inheritance Tax, even if you die within seven years of making the gift. You are allowed to give away a total of £3,000 each tax year without it counting towards the IHT arithmetic at all. And if you gave nothing away in the previous tax year then you can bring £3,000 forward from that year and give away £6,000 this year without running the risk of IHT being due on it, even if you die tomorrow.

If there is a wedding during the year then you can give up to £5,000 to a child of yours as a wedding gift – and up to £2,500 to a grandchild (or great-grandchild) or £1,000 to anyone else on their marriage. The gift has to be conditional on the wedding taking place.

You can combine these two exemptions. So you can give £5,000 to one of your children on their marriage **and** give them up to £3,000 as well. Apart from these two big exemptions, you can give away any number of small gifts up to £250 each to any number of separate people. However, these recipients cannot also get money from you under any other exemption.

You can also give away some of your income free of tax. If you have a high income and can afford to give away part of it without reducing your own lifestyle, then that part is completely exempt.

For example: *Alison Thomas inherited a good pension when her husband Denis died in 2005. She also has her own company pension and a state pension. Without Denis and as her age advances she does less and spends less. As a result her bank balance grows each month. She works out that she has at least £2,000 a year more than she needs and she could give that away without reducing her lifestyle. She already uses her full £3,000 a year for exempt gifts, which she shares each year between her two children Charles and Mary. She gives the £2,000 excess income in monthly instalments to her only granddaughter, Jade, who is a single parent and needs the money to pay for childcare. Alison is glad she can give this money to a younger member of the family rather than it accumulating in her bank and being liable for tax when she eventually dies.*

If you make a gift using this rule, you should write a note explaining the arithmetic and keep it with your papers.

In some circumstances you can also pay money for maintenance without it counting as part of your estate.

There are three separate exemptions set out in Inheritance Tax Act 1984 s.11.

- **Gifts to your ex-spouse (or ex-civil partner) for their maintenance are exempt.**
- **Gifts to your children (but not grandchildren or other relatives) are exempt while they are in full-time education if the money is given for their maintenance or the costs of their education or training. So if a parent pays off a child's student loan or pays their tuition fees then that payment should be exempt from IHT.**
  Take care to pay it while they are still a student or at the very latest by the 5 April following the end of their full-time education or it may not be exempt.
- **Gifts for the maintenance of any relative who is financially dependent on you are exempt.**

All these allowances are personal. So two parents can each give £3,000 a year and if they gave away nothing last year, they can give £12,000 this year between them, without it counting as part of their estate. If they are married or civil partners it doesn't even matter if only one of them has the money – one can give the money to the other, who can then make the exempt gift with no tax consequences. That will usually be true of two unmarried individuals as well.

All these amounts are completely exempt from IHT however short a time you live after making them. Remember that if you live for seven years after making any gift then that is also completely exempt – subject to the Gifts with Reservation of Benefit rules as explained on page 11.

A spouse who has inherited everything from their late husband or wife is not completely free to give that property away. If the person who has died left any instructions to make gifts out of the property and the survivor makes gifts according to those instructions within two years of the death then those can be counted as if they had been made out of the estate. That would reduce the allowance available to be passed on when the widow eventually dies. If you want your widow to pass things on after your death it is safest to convey that information verbally and not to make it binding. Otherwise the gifts should not be made for at least two years after the first death.

There is no obligation to keep records of gifts – exempt or not – that you make while you are alive. However, there is an obligation on your executors to discover them all and to make sure the correct Inheritance Tax is paid. So it is very helpful to your executors – who will normally be your heirs – to keep a note of gifts that you make. If you think they are exempt gifts then explain why. Keep these documents with your will or other papers so that they are easily found.

If the total value of your estate is below the IHT threshold then you can give away as much as you like. (But, on the other hand, you can't 'deliberately deprive yourself of assets' to avoid paying care fees, for example.)

One final point on gifts. Never give away money that you need. It is your money, not your heirs'. You worked hard for it and you should benefit from it during your own life.

Leaving money to charity

Anything left in your will is completely exempt from Inheritance Tax if it is given to:

- **a registered charity,**
- **a university,**
- **a national museum or art gallery,**
- **a political party which at the General Election before the death got at least two MPs elected to the UK Parliament or got one MP and at least 150,000 votes nationally. (That rule applies to nine political parties in the 2010 Parliament – the eight which have at least two MPs and the Green Party which got one MP and 285,612 votes nationally.)**
- **any other body for 'national purposes'. That phrase is explained in Schedule 3 of the Inheritance Tax Act 1984.**

A new rule began on 6 April 2012 that reduces the amount of IHT due on an estate if at least 10% of the taxable amount is given to a charity – but not to one of the other exempt bodies, unless of course it is also a charity.

The calculation is complicated.

Deduct the nil-rate band (threshold) from the net estate after all debts and so on have been deducted. That leaves the taxable estate or what HMRC calls the 'baseline amount'. If the gift to charity is at least 10% of the baseline amount then the balance after the gift to charity is taxed at 36% not 40%.

For example: *John expects to leave £500,000. His taxable estate is £500,000 - £325,000 = £175,000. Normally the tax due on that estate would be £175,000 x 40% = £70,000.*
But John decides to give £20,000 to a registered charity that rescues donkeys. That is more than 10% of his taxable estate so after it is deducted the balance of £155,000 is taxed at 36% not 40%.
The tax due is £55,800 instead of £62,000. His children share £99,200 instead of £93,000.
A gain to each of them of more than £2,000.

Giving money to charity may be a laudable thing to do. However, it should be done for its own sake not as a way to avoid tax. Even with the new rules your heirs will be better off if you leave everything to them.

For example: *If John had not given the money to the donkey charity, his children would have shared £105,000 instead of £99,200. A gain to each of more than £1,900.*

This charity relief applies only to a death that occurs on or after 6 April 2012.
It can be complex to work out. For more details see
hmrc.gov.uk/inheritancetax/pass-money-property/charity-reduce.htm

Life Insurance

If you have a life insurance policy that pays out on your death, the money will normally form part of your estate. The same is true of a death-in-service benefit or insurance paid as part of a pension or some sorts of mortgage. However you can usually avoid IHT being due by making the policy 'written in trust'. That means instead of going directly to your dependants the money is paid into a trust, which then passes it on to your dependants. That two-step process avoids the proceeds counting as part of your estate. However, this arrangement is slightly more difficult following recent changes in trust law.

In the past, the proceeds would be paid into what is called a 'discretionary trust' where the trustees decide who to pay the money to and when. They will be employees of the insurance company and will follow your request set out in what is called a 'letter of wishes'. If such a discretionary trust was written before 22 March 2006 then the arrangement works and no tax is due. But if it was written to a discretionary trust after that date and the value of the policy is more than £325,000, then a tax charge of 20% of the excess will be made when the policy is transferred to the trust. If the trustees do not pass over the money to the heirs at once then every ten years another charge of around 6% on the excess over the nil-rate band (threshold) will be due.

An alternative is to write the policy into what is called a 'bare trust'. With a bare trust the trustees make no decisions – the policy belongs to the people named in the trust, who would normally be your heirs. Bare trusts are not subject to any special tax regime – the money is taxed as it arises as belonging to the recipient. There would normally not be any tax due on the premiums you pay or the pay out on your death.

Ask your insurance company if your policy has been written in trust; if it has not, ask how you can do so and make sure it is a bare trust not a discretionary trust if the value is likely to be more than £325,000. Some insurance companies may make a charge and some are less than helpful.

If you have considerable assets and want to give money away in the hope that you will live seven years, you can take out a specific life insurance policy that will pay the IHT due on your estate if you die within seven years. The policy should be a pure life insurance policy with no investment element and, of course, the proceeds should be written into a bare trust. Such policies can be very cheap for people in their fifties but of course the older you get the more expensive they become. If you are one of a married couple or civil partnership, it is normally cheaper if the younger partner makes the gift and takes out the life insurance policy.

Armed forces

If a person's death was due to active service in the armed forces – or was hastened by it – then their whole estate is completely exempt from inheritance tax. Many people can benefit from this little-known rule. It was used by the executors of the fourth Duke of Westminster in 1967. His family, one of the wealthiest in Britain, successfully claimed his death from cancer had been 'hastened' by a stomach wound he suffered fighting in France in 1944 and paid no inheritance tax at all. But many people of much more modest means can also benefit from this exemption, which has existed for more than 300 years. The law is now section 154 of the Inheritance Tax Act 1984. If you think it may have applied to the estate of someone who has already died, you should apply to the capital taxes office for a refund of the tax – plus interest from when it was wrongly paid.

Older widows

A special exemption from IHT applies to the estates of some – but by no means all – women who were **widowed before 13 November 1974**. Whether the exemption applies depends on how the widow inherited the property from her late husband. The most straightforward way to inherit is what the lawyers call 'absolutely'. She becomes the owner of the property and can do what she wants with it. Nowadays this is the normal way for property to be left in a will. The other, more old-fashioned, way to inherit is called an 'interest in possession' in the property, sometimes known as a 'life interest'. That means that for the rest of her life she can live in the family home and have the income from any investments. But legally she is not the owner of the property. It is owned by a trust and when she dies the trust will pass the property on to the heirs, usually her children, and no IHT is due.

The exemption from IHT applies only to widows whose late husband left them **a life interest in the property**. It does not apply to widows who were left the property absolutely. The law is Inheritance Tax Act 1984 Schedule 6 paragraph 2. You can find out how the estate was left from the late husband's will. If you no longer have a copy you should be able to get one from the local Probate Registry in England or Wales, the local Sheriff's Court or National Archives of Scotland or the Public Record Office of Northern Ireland. See 'further information' below for details of how to contact them.

If a husband died before 13 November 1974 and had no will, then it is possible that under the intestacy rules that then existed, some of the property above a certain amount will have been put into a lifetime trust for the benefit of the widow. If so that part of the estate may now be exempt from IHT.

If the widow was left property absolutely and it was below the exempt amount for estates at the time, there may still be some allowance that can now be used by her heirs when she dies under the new rules for couples described earlier.

POINTS TO BE AWARE OF

Equity release

Some advisers will suggest you take out what is called an 'equity release' plan to **reduce your liability to Inheritance Tax**. It works like this. You borrow money against the value of your home. While you are alive you pay no interest on the loan. When you die, the loan and all the accrued interest is paid from the value of your home which is therefore reduced and the Inheritance Tax is also reduced or disappears completely.

Equity release might be a perfectly sensible way of raising money if you need more income or capital in retirement. And it goes without saying that taking out an equity release product will reduce the amount of your estate and the tax due. But that is a side effect. You should never embark on equity release just to reduce IHT. If you do not need extra capital or income then equity release should never be considered. It is better for your heirs to have 60 per cent of something than 100 per cent of nothing.

Property abroad

If you move abroad, then property you still own in the UK can be liable to Inheritance Tax here. It may also be liable to tax in the country where you die and the Inheritance Tax due there may be much more than you would pay in the UK. It is vital that you make a will under the local jurisdiction when you arrive.

If you live in the UK and you have property abroad, it will normally be part of your estate for UK Inheritance Tax. But it may also attract tax in that country.

In either case, there are agreements in place with some countries – though not all – to ensure your estate is not taxed twice. The question of where and how an estate is taxed is very complex and if you have substantial assets in a country where you do not normally live, you should seek advice from a lawyer or accountant who specialises in these matters in both jurisdictions.

A spouse who lives in the UK but is not what the Revenue calls 'domiciled' here cannot inherit unlimited property from her partner free of IHT. Only the first £55,000 is free of IHT.

Avoidance schemes

Some insurance companies and financial consultants have made a lot of money selling plans to **reduce or avoid Inheritance Tax**. Such schemes can be complicated – involving juggling the ownership of money or making gifts into or from trusts – and often involve taking out an insurance policy. These schemes are often designed principally to generate commission for the person who sells them. If the scheme does not work it is your heirs, not the adviser, who will end up paying the bill. In 2005 the government clamped down on one kind of scheme, leaving 30,000 people, who had paid good money for advice, with a tax bill every year just to carry on living in their own home. In 2006 major uncertainty was created when the government announced plans to change the way that trusts were taxed, without any consultation. Later it watered down the proposals but the changes have made deals involving trusts much less attractive. The current Government has warned that it will take action against any scheme which is set up just to avoid tax. In 2012 it announced that it would pass into law a new General Anti-Abuse Rule that will make it even harder to set up cunning schemes to avoid tax.

So generally such plans are best avoided. If you want to consider one, then **before you commit yourself** make sure it has the positive approval of HM Revenue & Customs, and discuss it with an impartial professional adviser – such as a solicitor or accountant – whom you have found yourself and who is entirely separate from the company or individual selling the product.

PROBATE

Many people agree to be an executor of a will but find the details of what they have to do when the person dies rather more than they expected. Once a person has died the executors of the estate are responsible for valuing all the assets, assessing and deducting any debts, and for delivering an account of the value of the estate to the Probate Registry. When they do that they also have to pay any Inheritance Tax that is due. Only then will what is called 'probate' be granted and the estate released so that debts can be paid and the balance sold or distributed among the heirs.

The procedure is the same in Scotland but it is called an 'inventory' and has to go to the Sheriff Clerk who grants 'confirmation'. Similar rules apply in both jurisdictions if someone dies without a will; the next of kin is usually appointed as an administrator to the estate doing the same job as the executors.

For small estates below the IHT threshold, especially where all the property is left to a spouse, a formal application for probate is not always necessary.

If you come across points that you are not sure about you can always take your questions to a lawyer who specialises in this kind of work. They will then charge you by the hour to answer them. You then use that information to proceed with probate. Always use a solicitor who is a member of the Society of Trust and Estate Practitioners (STEP). One question you should always ask when dealing with an estate is whether a Deed of Variation (see page 9) could be used to reduce the Inheritance Tax due.

If the estate contains valuables or property then it is important to get them valued by a recognised professional. Their fees can be deducted from the estate. An estate agent will value a home. Jewellery should be valued by a member of the Institute of Registered Valuers. Shares and other investments should be valued at the date of death.

Any Inheritance Tax due has to be paid before probate (or confirmation) is granted. In other words, the tax has to be paid before the assets can be released to pay it. Some assets of the deceased can be used to pay the tax, including National Savings & Investments products and money in an account at most banks and building societies. But if these assets are not enough – and often they will not be if a house is involved – then the executors have to borrow the money to meet the IHT bill. Some High Street banks will make a short-term loan to the executors to pay the Inheritance Tax. Although the interest rate may be high the loan will only be needed for a short time so the cost will be modest. Make sure that you claim any interest due on this loan as an expense against the estate. If a substantial part of the estate is the value of a property then the IHT due on that part can be paid in ten annual instalments. Interest is due on the unpaid tax. Since 29 September 2009 the rate is set at 3% but that may change in the future.

Although working out liability can be complicated the Revenue expects you to do it within six months. The deadline for paying IHT is six months after the end of the month in which the person died. So if someone dies in November, the IHT has to be paid by the end of May. If it is not then interest on the tax due starts the next day, 1 June. The rate of interest on unpaid IHT is currently 3%. If the IHT is not paid for another six months then penalties may be charged. There are also penalties if the IHT account contains errors.

Falling house prices

In many parts of the country house prices are falling. So executors who are in the middle of working out the tax due on an estate may feel that the price of the family home at the date of death is not correct by the time the tax is paid. Property that took an estate above the threshold for Inheritance Tax a year ago may now be worth less and that could reduce the tax due or even wipe it out altogether. Similar considerations may apply if part of the estate was in shares and prices have fallen sharply.

Strictly speaking tax is due on the value of the estate on the day of the death. Given the extraordinary current circumstances it is possible – though not very likely – that the Revenue would allow a revaluation of the estate. It is certainly worth asking. A more certain way is to sell the shares or property shortly after the death. Then statutory rules apply that can cut the tax even after it has been paid.

If the executors sell the property within four years of the death and it fetches a lower price than the valuation then the tax can be recalculated using that lower value. A similar rule applies to shares but they must be sold within twelve months of the death. If the items are sold within that time scale then the claim for the tax refund can be made up to six years after the tax was paid.

When you make a will it is better to name the main beneficiaries as executors rather than including a bank or solicitor. Although a professional will usually do the job competently, they will charge a percentage of the value of the estate – up to 4% on a small estate, less on a larger one. If they charge an hourly rate instead of a percentage, then that is an open-ended commitment and the hours worked – and the cost – are in the solicitor's hands. Either way the charges will reduce the value of the estate to the heirs.

More than one death

If someone dies within five years of inheriting property from an estate where Inheritance Tax was due, the tax due on their death can be reduced.

It is called successive charges relief (or sometimes still 'quick succession relief') and applies on a sliding scale if someone dies up to five years after inheriting property themselves. It can apply only if they paid tax on that inheritance.

For example: *Marjorie Dawes died in January 2004 leaving her house and belongings to her daughter Patricia. The estate was worth £385,000 and £40,000 IHT was paid. Patricia, who is widowed, dies in July 2006, less than three years after her mother's death. Her daughter Gemma inherits all her property. As her mother has already paid IHT on some of the property she inherited, Gemma will get some relief from tax on her mother's estate. The arithmetic is complicated but Gemma will be able to inherit an extra £21,500 without paying tax on it.*

If you think you may be in this position always ask the Revenue for advice.

Large lifetime gifts

If someone makes a large gift, more than the nil-rate band (threshold), and they die within seven years of making it, then tax is due on that gift and has to be paid by the recipient.
See *Appendix 3* on page 27 for details and seek professional advice.

FURTHER INFORMATION

The Revenue has scrapped all its printed leaflets on Inheritance Tax. They have been replaced by the less helpful guidance on the website, which begins at
hmrc.gov.uk/inheritancetax

The Revenue's Probate and IHT Helpline is very helpful on 0845 302 0900 or 0115 974 3009.
If you want even more detailed information you should consult the IHT manual that contains the guidance used by Revenue staff. You can view it at
hmrc.gov.uk/manuals/ihtmanual/index.htm.

There is a useful guide to applying for probate in England & Wales on the Courts Service website
justice.gov.uk/courts/probate/applications

Which? publishes an excellent guide called *Wills & Probate* , currently £10.99. It explains how to value an estate, what accounts you should keep, and how to obtain probate.

The Revenue's capital taxes offices are at

England and Wales HM Revenue & Customs Capital Taxes, Ferrers House,
PO Box 38, Castle Meadow Road, Nottingham NG2 1BB

Scotland HM Revenue & Customs Capital Taxes, Meldrum House,
15 Drumsheugh Gardens, Edinburgh EH3 7UG

Northern Ireland HM Revenue & Customs Capital Taxes, Level 3 Dorchester House,
52-58 Great Victoria Street, Belfast BT2 7QL

The Inheritance Tax Act 1984 – updated with amendments over the years – is available online at
legislation.gov.uk/ukpga/1984/51

You can find old wills from England and Wales through the Probate Registry in London, tel 020 7947 6939. There are also local probate offices – details from
justice.gov.uk/courts/probate/probate-regstries

In Scotland contact National Archives of Scotland, tel: 0131 535 1314
nas.gov.uk or the Sheriff's Court closest where the deceased lived before they died.

In Northern Ireland contact the Public Record Office, tel: 028 9025 1318.
proni.gov.uk

The Land Registry website is at
landregistry.gov.uk or you can contact your local Land Registry.

If you want to find a professional to give you help or advice, a good place to start is the Society of Trust and Estate Practitioners. Its members are all lawyers and professionals who specialise in sorting out estates and reducing inheritance tax.
step.org or call 020 7340 0500 to get a list of local members.

GLOSSARY

Administration	*See Letters of Administration*
Baseline Amount	The net estate minus the applicable *Nil-Rate Band*. It is used to assess how much must be left to charity for the rest of the estate to be taxed at the reduced rate of 36%.
Capital Transfer Tax *(CTT)*	Replaced *Estate Duty* for deaths from 13 March 1975. The lifetime gift part of the tax began on 13 November 1974.
Confirmation *(Scotland)*	*See Probate*
CTT	*See Capital Transfer Tax*
Deed of Variation	A procedure to change a will after a death. All the beneficiaries have to agree and it has to be done within two years of the death. The procedure can be used to reduce Inheritance Tax and to change the way married couples leave their property.
Estate	The property and money left by someone who has died.
Estate Duty	A tax on estates introduced in the 19th century. It was simplified in 1949 and replaced by *Capital Transfer Tax* on 13 March 1975.
Executor	The person appointed in a will to wind up the estate of someone who has died. Usually a beneficiary of the will, sometimes a professional such as a bank or solicitor. A female executor is sometimes called an executrix.
Exempt Gifts	Made before death that are within the rules to be exempt from Inheritance Tax whenever the donor dies.
Gift with Reservation of Benefit *(GROB)*	A gift made before death but which the donor maintains an interest in. Such a gift will still count as part of their estate at death.
GROB	*See Gift with Reservation of Benefit*
Inheritance Tax Allowance or IHT Allowance	The informal phrase for *Nil-Rate Band* or *Threshold*.
Intestate	Someone who dies without a valid will is said to be intestate.
Joint Owners *(Scotland)*	*See Tenants in Common*

Joint Owners with Survivorship *(Scotland)*	*See Joint Tenants*
Joint Tenants	Where two or more people own a property jointly. On the death of one the other becomes the owner of the whole property. In Scotland called *Joint Owners With Survivorship*. See also *Tenants in Common*.
Letters of Administration	The equivalent of probate when a person dies without a will. Sometimes abbreviated to 'admons'.
Lifetime Gift	Any gift made before death but normally one that exceeds the gifts that are exempt. See also *Potentially Exempt Transfer*.
Nil-Rate Band	The threshold at which IHT starts to be due on an estate. Also called the *IHT Allowance*.
Notice of Severance	The process of changing the ownership of a property from *Joint Tenants* to *Tenants in Common*.
Potentially Exempt Transfer	A gift made before death that is not an *Exempt Gift*.
Probate	The process of winding up an estate after a death, paying the Inheritance Tax, and getting permission to distribute the assets to the beneficiaries.
Tenants in Common	Two or more people who own a property and where each owns a specific share, usually half, which they can then separately leave to their heirs. In Scotland called *Joint Owners*. See also *Joint Tenants*.
Testator	The person who makes a will. A woman is sometimes called the testatrix.
Threshold	*See Nil-Rate Band*
Trust	A legal arrangement where property is owned or controlled by trustees on behalf of someone else.
Will	The legal document that gives instructions as to how your property is to be disposed of after your death.
Witness	A person who signs a will stating that they have seen the testator signing it.

APPENDIX 1

Historical allowances for death taxes

These historical allowances are used to work out the allowance that is left to pass on to a surviving spouse who dies on or after 9 October 2007. If the first death was on 13 March 1975 or later the position is straightforward as both CTT and IHT allow unlimited inheritance by a spouse. Any bequests to other people use up some of the allowance listed here.

If the first spouse died before 13 March 1975 when CTT replaced Estate Duty the position is slightly more complex. Up to 21 March 1972 no tax-free transfer to a spouse was allowed. So any bequest to a spouse uses up part of the nil-rate band. If the spouse was left £10,000 in, say, 1970 then no nil-rate band (threshold) would be left for her estate to benefit from on her death now. That will cause particular problems for deaths before 10 April 1946 when only the first £100 was exempt.

From 22 March 1972 there were two allowances, both of £15,000. A spouse could be left up to £15,000 free of Estate Duty. Another £15,000 was available to leave to anyone else free of Estate Duty. Any bequest to a spouse for more than £15,000 uses up some of the £15,000 that could be left tax-free to other people. So if a spouse was left £15,000 or less her bequest does not affect the allowance that is used. If she was left more than £15,000 that uses up some of the tax-free allowance. If she was left £30,000 then no tax-free allowance is left at all.

For example: *Michael died in 1973. He left £20,000 to his wife Angela and £2,500 to his son John. The £20,000 he left to Angela is tax free using up the £15,000 tax-free allowance to a spouse and another £5,000 of the general allowance. That leaves £10,000 general allowance and another £2500 of that is used up by the bequest to John. So Michael has used up £7,500 of the general £15,000 allowance which is half of it. That leaves half to be passed on to Angela. She dies in 20012/13 when the full allowance is £325,000. So she will have her own allowance of that much plus half of £325,000 which is £162,500 making a total of £487,500. If her estate is less than that, no tax will be due.*

Historical nil-rate band allowances

Date of death*			Allowance
Estate Duty			
16/08/1914	to	09/04/1946	**£100**
10/04/1946	to	29/07/1954	**£2,000**
30/07/1954	to	08/04/1962	**£3,000**
09/04/1962	to	03/04/1963	**£4,000**
04/04/1963	to	15/04/1969	**£5,000**
16/04/1969	to	30/03/1971	**£10,000**
31/03/1971	to	21/03/1972	**£12,500**
22/03/1972	to	12/03/1975	**£15,000****
Capital Transfer Tax			
13/03/1975	to	26/10/1977	**£15,000**
27/10/1977	to	25/06/1980	**£25,000**
26/06/1980	to	08/03/1982	**£50,000**
09/03/1982	to	14/03/1983	**£55,000**
15/03/1983	to	12/03/1984	**£60,000**
13/03/1984	to	05/04/1985	**£64,000**
06/04/1985	to	17/03/1986	**£67,000**
Inheritance Tax			
18/03/1986	to	16/03/1987	**£71,000**
17/03/1987	to	14/03/1988	**£90,000**
15/03/1988	to	05/04/1989	**£110,000**
06/04/1989	to	05/04/1990	**£118,000**
06/04/1990	to	05/04/1991	**£128,000**
06/04/1991	to	09/03/1992	**£140,000**
10/03/1992	to	05/04/1995	**£150,000**
06/04/1995	to	05/04/1996	**£154,000**
06/04/1996	to	05/04/1997	**£200,000**
06/04/1997	to	05/04/1998	**£215,000**
06/04/1998	to	05/04/1999	**£223,000**
06/04/1999	to	05/04/2000	**£231,000**
06/04/2000	to	05/04/2001	**£234,000**
06/04/2001	to	05/04/2002	**£242,000**
06/04/2002	to	05/04/2003	**£250,000**
06/04/2003	to	05/04/2004	**£255,000**
06/04/2004	to	05/04/2005	**£263,000**
06/04/2005	to	05/04/2006	**£275,000**
06/04/2006	to	05/04/2007	**£285,000**
06/04/2007	to	05/04/2008	**£300,000**
06/04/2008	to	05/04/2009	**£312,000**
06/04/2009	to	05/04/2015	**£325,000**

** From 1946 to 1971 the dates are slightly different in Northern Ireland.*
Full details at www.hmrc.gov.uk/rates/iht-thresholds.htm
*** There was also an additional £15,000 allowance specifically for gifts to a spouse.*

APPENDIX 2

Splitting an estate

In the past married couples were given complex advice about splitting the ownership of their home and each leaving half to their children. That advice is normally no longer required. But in one limited case it might be. Where a person is married to someone who has been widowed and who can inherit the tax allowance of their previous partner, then the new spouse can reduce the tax their heirs pay by making sure he or she bequeaths them assets up to the nil-rate band (threshold). This appendix explains briefly how to do that.

For example, Jonathan married Mathilda in 1980. She was already a widow, *having lost her first husband Mick in a works accident. Mick and Mathilda owned their property together and when Mick died Mathilda inherited it all. When she dies her heirs will be able to bring forward Mick's unused tax allowance and Jonathan's up to a maximum total of 100%. However, as Mick's is already 100% there is no advantage in adding Jonathan's allowance, so he might as well use it himself.*

He does that by leaving as much as he can to his heirs. If he has free assets that Mathilda will not need then he can leave those to their children (or anyone) up to the value of the nil-rate band (threshold), currently £325,000. But in fact Jonathan is not that wealthy. And what savings he has he wants Mathilda to enjoy should he die first. Their main asset is their home which is worth around £500,000.

Like most couples, Mathilda and Jonathan own their home as what are called 'joint tenants' (in Scotland it is called 'joint owners with survivorship'). When one dies, the other simply becomes the owner of the property without formality. But there is a different way of owning a home which is called 'tenants in common' (in Scotland they use the much more sensible term 'joint owners'). Under this form of ownership, each partner owns a specific share of the property, usually half. In that case each partner is free to leave their half of the property to their heirs separately.

In order for Jonathan to leave half the home to the children they must change the way they own it (see below).

In England and Wales you change from being joint tenants to tenants in common by issuing what is called a Notice of Severance. This is simply a document which one of you sends to the other – it does not matter which of you does this – at your home address saying 'I hereby sever our joint tenancy of <address> and in future we shall own that property as tenants in common in equal shares.' Make two copies. Write your name, sign and date both and get your partner to write 'I acknowledge receipt of this Notice of Severance' on both and write their name and sign and date both.

If your property is not registered with the Land Registry that is all you need do. Keep the Notice of Severance with the documents relating to your ownership of the property.

If your property is registered – and most of it is now – you must then register the change in the way it is owned with the Land Registry.
There is now a useful guide and the forms you will need online at
landregistry.gov.uk/public/guides/public-guide-18.

When you have filled in the form, keep a photocopy and send the original with the documents relating to your property. Tell your heirs what you have done.

In Scotland or Northern Ireland you should see a solicitor about making this change.

Dangers

You must each write a will leaving your share of the house to your heirs without conditions. You must not specify that the survivor must be allowed to live there. If you do, when the second spouse dies the whole house will be treated as their property. So you have to trust your children. As joint owners any of them could insist it be sold at any time. Even if you trust your children, if any of them divorces or goes bankrupt, the courts could order the house to be sold to realise their share, leaving the survivor with nowhere to live. In addition, the children will own a share of a home that they do not live in and that will count as their capital and could prevent them from claiming Income Support, Housing Benefit or Council Tax Benefit *(but not tax credits)*.

There is another risk to the heirs. On the first death they will become part owners of a home in which they do not live. Any gain in value of their share, from the date they inherit to the date they finally sell it, will be liable to Capital Gains Tax. The tax due will depend on many factors but it will be less than the IHT that has been saved.

Trusts

There is a way round these problems that still achieves the stated objective. However, it carries risks of its own. Instead of each spouse leaving half the house directly to the children, they leave the value of it to what is called a discretionary trust, with the children as beneficiaries. On the first death the trust inherits half the house. Instead of insisting on payment, the trustees simply take from the survivor what is in effect an IOU promising to pay the money owed when he or she dies. The trust accepts this IOU and charges no interest. The debt is only repaid when the second spouse dies – by passing their part of the house to the trust, which passes it to the heirs who then own all the house. This legal mechanism stops the children owning any part of the property until the second parent's death. So it does not matter if they divorce, go bankrupt or need to claim means-tested benefits.

The risk is that a future government will act to prevent what is essentially an entirely artificial arrangement devised solely to avoid IHT. That seems unlikely, but it is not impossible. You can never be sure. The present government has acted to change the tax rules on trusts that are used for tax avoidance – and made them retrospective. There is also a risk that the Revenue will challenge these arrangements in court. If you want to make a trust like this it can be done by any competent solicitor when you update your will.

APPENDIX 3

Large lifetimes gifts

Special rules apply if you make gifts in the seven years before you die that exceed in total the IHT threshold that is current when you die. So if you give someone £1 million and you die within seven years, the £1 million absorbs the whole of the nil-rate band (threshold) of £325,000, leaving £675,000 to be taxed. The recipient of the gift has to pay this tax. As there is no nil-rate band left, the whole of the remaining estate is then taxed at the full rate of 40%.

If the gift was £325,000 and you died this year then the gift would use up the entire nil-rate band (threshold). There would be no tax to pay by the recipient. But there would be no nil-rate band left for the rest of your estate. So the heirs would have to pay the full 40% tax on the whole of the estate.

If instead of giving £1 million to one person you gave £100,000 to each of ten recipients then the band is used up chronologically. For example, if you gave away the money on ten successive days, starting on a Monday, the first three lucky recipients would not have to pay any tax. They would use up £300,000 of the band, leaving £25,000 for Thursday's child who would thus be taxed on the remaining £75,000. But the next six recipients – Friday to the following Wednesday – would each have to pay tax on the whole £100,000. As before, there would be no nil-rate band to use against the estate, so tax would be due on the whole of it at 40%. If the ten gifts were all made on the same day and at the same time then the nil-rate band would be apportioned between the gifts. Each would get one tenth of the nil-rate band, so £32,500 of each gift would be tax free and the rest would be taxable.

Rate of tax on gifts.

When tax is due on a pre-death gift it is not always charged at 40%. Gifts made within three years of death are taxed at the full 40% rate. But the rate is reduced for gifts made earlier than that. For gifts made between three and seven years of death the tax is reduced as set out in the table below. And of course gifts made at least seven years before the date of death fall outside the calculation and are not taxed and have no effect on the nil-rate band (threshold).

Time before death gift was made	Rate of tax on taxable gift
6 years but less than 7	8%
5 years but less than 6	16%
4 years but less than 5	24%
3 years but less than 4	32%
Less than 3 years	40%

These rates of tax are often expressed in a different way as a percentage of the standard 40% rate. So you may see them as 20% to 100% rather than 8% to 40%. That is not the rate of tax but the percentage of the full rate of tax. So 20% means 20% of 40% which is 8%.

These rules apply to gifts made to individuals. Gifts made into trusts may be subject to different rules. Seek advice from a qualified tax adviser.

Notes

Taming Inheritance tax

By Paul Lewis