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HOW TO SAVE INHERITANCE TAX

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How to Save Inheritance Tax

By Carl Bayley BSc FCA

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About the Author

Carl Bayley is the author of a series of 'Plain English' tax guides designed specifically for the layperson and the non-specialist. His aim is to help families, landlords, and other business owners understand the taxes they face and make savings through sensible planning and by having confidence to know what they can claim. Carl's speciality is his ability to take the weird, complex world of taxation and set it out in the kind of clear, straightforward language taxpayers can understand. As he often says, "My job is to translate 'tax' into English."

Carl enjoys his role as a tax author, as he explains, "Writing these guides gives me the opportunity to use the skills and knowledge learned over more than thirty years in the tax profession for the benefit of a wider audience. The most satisfying part of my success as an author is the chance to give the average person the same standard of information as the 'big guys' at a price everyone can afford."

Carl takes the same approach when speaking on taxation, a role he undertakes with great enthusiasm, including his highly acclaimed annual 'Budget Breakfast' for the Institute of Chartered Accountants. In addition to being a recognised author and speaker, Carl has spoken on taxation on radio and television, including the BBC's 'It's Your Money' programme and BBC Radio 2's Jeremy Vine Show.

Carl began his career as a Chartered Accountant in 1983 with one of the 'Big 4' accountancy firms. After qualifying as a double prize-winner, he began specialising in taxation. He worked for several major international firms until beginning the new millennium by launching his own practice, through which he provided advice on a wide variety of taxation issues; especially property taxation, inheritance tax, and tax planning for small and medium-sized businesses, for twenty years, before deciding to focus exclusively on his favourite role as author and presenter.

Carl is a former Chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales, and was a member of the Institute's governing Council between 2003 and 2023. He is also a former President of ICAEW Scotland and member of the ICAEW Board. He co-organised the annual Practical Tax Conference from 2002 to 2019.

Aside from his tax books, Carl is an avid creative writer and has just published his debut novel, *Trinity of Souls*. When he isn't working, he takes on the equally taxing challenges of hill walking and horse riding: his Munro tally is now 106 and, while he remains a novice rider, his progress is cantering along nicely. Carl lives in the Scottish Borders, where he enjoys spending time with his partner, Linda. He has three children and his first grandchild arrived in April 2021.

Contents

Chapter 1. Introduction		**1**
1.1	A Personal Note	1
1.2	There Are Two Certainties in Life	1
1.3	Guide Overview	4
1.4	Terminology, Abbreviations, and Examples	6
1.5	Why Worry?	8
1.6	A Guide to Effective Inheritance Tax Planning	9
Chapter 2. Inheritance Tax Principles		**12**
2.1	Transfers of Value	12
2.2	Who Is Liable for Inheritance Tax?	13
2.3	Who Actually Pays the Tax?	14
2.4	How Much Tax Is Payable?	15
2.5	What Is Your Estate?	15
2.6	The Basic Calculation on Death	16
2.7	Making the Payment	17
2.8	Grossing Up	19
2.9	Collection of Tax	21
2.10	Loans and Other Liabilities	22
2.11	Quick Succession Relief	27
2.12	Simultaneous Deaths	27
Chapter 3. The Main Exemptions		**29**
3.1	What Is an Exemption?	29
3.2	The Nil Rate Band (NRB)	29
3.3	The Spouse Exemption	31
3.4	The Residence Nil Rate Band (RNRB)	34
3.5	Gifts to Charities & Other Exempt Bodies	36
3.6	Charitable Legacies	37
3.7	Excluded Property	38
3.8	Other Exemptions	39
Chapter 4. Lifetime Transfers		**41**
4.1	Inheritance Tax on Lifetime Transfers	41
4.2	Chargeable Lifetime Transfers	41
4.3	Potentially Exempt Transfers (PETs)	43
4.4	Problems with PETs	44
4.5	Death within Seven Years of a Lifetime Transfer	46
4.6	Relief for Reduction in Value	50
4.7	Timing and Evidence	52
4.8	Gifts with Reservation	52
4.9	Why Not Just Give It All Away?	55
Chapter 5. Lifetime Exemptions		**57**
5.1	Absolute Exemption	57
5.2	The Annual and Small Gifts Exemptions	57
5.3	Gifts in Consideration of Marriage	59
5.4	Maintenance of Family	60

5.5 Normal Expenditure Out of Income 61
5.6 Other Exempt Transfers 63

Chapter 6. Inheritance Tax Planning for Married Persons 64
6.1 Scope of this Chapter 64
6.2 The Transferable Nil Rate Band (TNRB) & Residence Nil Rate Band (RNRB) 64
6.3 Using the Residence Nil Rate Band on First Death 65
6.4 Nil Rate Band Transfers in Practice 67
6.5 Remarriage 69
6.6 Separation & Divorce 70
6.7 Inheritance Tax Planning for Married Couples 71
6.8 The Second Time Around 75
6.9 Using the Transferable Nil Rate Band 78
6.10 Will Trusts 80
6.11 The Widow's Loan Scheme 81
6.12 The Spouse Bridge 82
6.13 The Family Debt Scheme 84
6.14 Married Couples with Mixed Domicile 85
6.15 The Opt-In Election 85

Chapter 7. The Tax Benefits of Business Property 89
7.1 Introduction 89
7.2 Just How Useful Is Business Property Relief? 90
7.3 Qualifying Businesses 91
7.4 Property Investment or Letting Businesses 92
7.5 Businesses Exploiting Land (and Buildings) 94
7.6 What Does Wholly or Mainly Mean in Practice? 97
7.7 Relevant Business Property 98
7.8 What Is the Value of a Business? 100
7.9 Business Property Relief for Shares and Securities 101
7.10 Financing a Business 103
7.11 Deducting Liabilities: Unincorporated Business 105
7.12 Deduction of Liabilities for Company Owners 107
7.13 Borrowing to Invest in Your Business 110
7.14 Liabilities Incurred Before April 2013 110
7.15 Multiple Transfers 111
7.16 The Minimum Holding Period 112
7.17 Replacement Business Property 112
7.18 Extra Rules for Lifetime Transfers 113
7.19 How to Preserve Business Property Relief 115
7.20 Maximising Business Property Relief 118
7.21 Director's Loan Accounts 119
7.22 Sheltering Investments with Business Property Relief 120
7.23 Changing the Business to Save Inheritance Tax 122
7.24 Business Succession Planning 122
7.25 Smaller Shareholdings 123
7.26 The AIM Exemption 123
7.27 Aiming Too High 125
7.28 Agricultural Property Relief (APR) 126
7.29 Farmhouses 127

7.30	The Safety Net	128
7.31	Make Hay While the Sun Shines	128
Chapter 8. Inheritance Tax Planning with Trusts		**130**
8.1	What Is a Trust?	130
8.2	What Types of Trust Are There?	131
8.3	What Is an Interest in Possession?	132
8.4	Discretionary Trusts	133
8.5	Inheritance Tax Regimes for Trusts	133
8.6	Transfers into Trust	134
8.7	The Trust Hierarchy	135
8.8	Bare Trusts	135
8.9	Bereaved Minors' Trusts	136
8.10	Old Interest in Possession Trusts	137
8.11	Disabled Trusts	137
8.12	Immediate Post-Death Interests	138
8.13	Transitional Serial Interests	139
8.14	18 to 25 Trusts	139
8.15	Relevant Property Trusts	140
8.16	End of Trust Interests within Beneficiary's Estate	140
8.17	The Relevant Property Regime	141
8.18	Ten-Year Anniversary Charges	142
8.19	Exit Charges	144
8.20	Income Tax for Trusts	146
8.21	Stamp Taxes for Trusts	147
Chapter 9. More Advanced Planning with Trusts		**148**
9.1	The Relevant Property Trust Shelter	148
9.2	How Useful Is the Relevant Property Trust Shelter?	152
9.3	How to Avoid Anniversary and Exit Charges	153
9.4	How to Avoid Inheritance Tax and Capital Gains Tax at the Same Time	154
9.5	Investment Property Trusts	155
9.6	Passing Assets Tax-Free to Adult Children and Other Beneficiaries	158
9.7	Passing Assets Tax-Free to Minor Children	158
9.8	Discounted Gift Trusts	160
9.9	Loan Trusts	161
9.10	Excluded Property Trusts	161
Chapter 10. Using Pensions in Inheritance Tax Planning		**163**
10.1	A Beneficial Regime	163
10.2	Pensions and Inheritance Tax	164
10.3	Who Inherits the Pension?	166
10.4	What Do They Inherit?	167
10.5	Death Benefits and Income Tax	168
10.6	Inheritance Tax Planning with Pensions	172
10.7	Tactics and Limitations	181
10.8	Pensions for Company Owners	191
10.9	Bypass Trusts	194
10.10	Will it Last?	195

Chapter 11. Practical Aspects of Inheritance Tax Planning **197**
11.1 The Bigger Picture 197
11.2 Valuations 198
11.3 Related Property 199
11.4 Jointly Held Property 200
11.5 Mortgages 203
11.6 Residential Care Fees 203
11.7 Wills, Intestacy, and Statutory Rights 204
11.8 Life Insurance 206
11.9 Lottery Syndicates 208
11.10 Minor Problems 208
11.11 Anti-Avoidance Measures 210
11.12 The Pre-Owned Assets Charge 212
11.13 Foreign Issues 214

Chapter 12. Interaction with Capital Gains Tax **215**
12.1 A Quick Capital Gains Tax Update 215
12.2 The Uplift on Death 216
12.3 The Capital Gains Tax vs Inheritance Tax Dilemma 216
12.4 Gifts of Business Assets 217
12.5 Business Property Relief (BPR) and Business Asset Disposal Relief (BADR) 218
12.6 Transfers to Spouses or Civil Partners 225
12.7 Capital Gains Tax and the Family Home 226
12.8 Capital Gains Tax and Gifts with Reservation 227
12.9 Exempt Transfers 228
12.10 Other Assets 229
12.11 Capital Gains Tax and Trusts 231

Chapter 13. The Family Home **233**
13.1 When Our Main Asset Becomes Our Main Liability 233
13.2 Move Out Then Give It Away 234
13.3 Sell Up or Re-mortgage 235
13.4 Sale at Market Value 236
13.5 The Widow's Loan Scheme & The Family Home 236
13.6 Leave a Share to the Children 237
13.7 Leave a Share to a Discretionary Trust 239
13.8 The Full Consideration Method 239
13.9 Co-Ownership 240
13.10 The Three-Way Split 240
13.11 Downsizing 241
13.12 The Residence Nil Rate Band and Gifts with Reservation 244

Chapter 14. Family Investment Companies **248**
14.1 Introduction to Family Investment Companies 248
14.2 Shell Companies and Loan Accounts 248
14.3 Optional Extras 252
14.4 Growth Shares 254
14.5 Pick and Mix 256
14.6 More Optional Extras 256

Chapter 15. Other Advanced Inheritance Tax Planning Ideas **259**
15.1 Business Buy Back 259
15.2 The Double Dip 260
15.3 Money Box Companies 262
15.4 Corporate Debt 262

Chapter 16. Domicile and Emigration **264**
16.1 Domicile Principles 264
16.2 Legal Domicile 264
16.3 Deemed Domicile 267
16.4 A Guide to Emigration 268

Chapter 17. The Inheritance Tax Planning Timetable **271**
17.1 It's Never Too Early to Start 271
17.2 Marriage 271
17.3 Becoming a Parent 271
17.4 Adult Children 272
17.5 Your First Grandchild 272
17.6 Grandchild's Eighth Birthday 272
17.7 Middle Age 272
17.8 Retirement 272
17.9 Losing a Parent 273
17.10 Still Together After All These Years 273
17.11 Losing a Spouse 273
17.12 Remarriage 274
17.13 Life Expectancy Over Seven Years 274
17.14 Life Expectancy Three to Seven Years 275
17.15 Life Expectancy Two to Three Years 275
17.16 Loss of Capacity 275
17.17 Deathbed Planning 276

Chapter 18. Planning After Death **281**
18.1 Deeds of Variation 281
18.2 Disclaimers 282
18.3 Transfers Out of Trusts within Two Years 283
18.4 Second Chances 283
18.5 Post-Mortem Relief 283

Appendices
A UK Tax Rates and Allowances 285
B Connected Persons 286
C Sample Documentation 287
D Abbreviations Used 289

Chapter 1

Introduction

1.1 A PERSONAL NOTE

I'll make no bones about it. I find the concept of taxing people for dying morally repugnant. So I have an especially strong desire to help people save Inheritance Tax.

To be honest, I have always found this a difficult subject to write about: not because of the undoubted technical complexities – as a tax author, I am well and truly accustomed to that. No, I find this particular tax difficult to write about from an emotional perspective, because it is, inevitably, largely about death. My first introduction to the topic, as a young accountancy student, came within weeks of my own mother's death and that, perhaps, may be why I have always found the subject somewhat distressing.

Nonetheless, as a professional tax writer, I have always tackled this subject to the best of my abilities and strived to give readers the quality of information and guidance they deserve, just as in all my guides. I am confident I have succeeded in this aim and I believe the guide you have here is as comprehensive and detailed as anyone could wish for.

But to help me, and I hope you too, deal with the emotional aspects of the subject, I have always tried to inject some humour into the topic. Sometimes, particularly in the last few years, I have wondered if this humour is still appropriate and whether, perhaps, I should re-write the guide to reflect a more serious tone. I have considered this approach but, in the end, I still believe in trying to put a smile on people's faces (including my own), even when tackling such an emotive issue. So, the humour, such that it is, remains. If I offend anyone, I sincerely apologise, but I hope most readers will simply smile at my efforts.

When it comes to tax, I firmly believe no-one should ever pay more than their fair share. Taxpayers have every right to undertake sensible planning measures to legitimately reduce, or delay, their tax bills; especially to protect their family.

That's what this guide is all about. And, whatever form your family takes, be it a traditional spouse and children, or be it a collection of people connected only by the fact you want to take care of them, I fervently hope this guide helps you protect it.

1.2 THERE ARE TWO CERTAINTIES IN LIFE

Generally speaking, I find the oldest sayings are the truest. One old saying is, 'There are two certainties in life: Death and Taxes.'

The point where these two great 'certainties' meet is Inheritance Tax, and it is through the medium of this tax the Government will aim to get its final pound of flesh from you, just as you have departed this life.

Most people spend their lifetime trying to accumulate a reasonable amount of wealth, to take care of themselves in old age and then pass on any remaining surplus to their children. Much of the Government's fiscal policy is aimed at encouraging this behaviour.

It is somewhat unfair then, that without careful planning and a great deal of pre-emptive action, many families will ultimately face a huge Inheritance Tax bill. Unchecked, this tax bill will rob your family of a significant proportion of their rightful inheritance: up to 40% of it, in fact.

Most people are absolutely appalled at this prospect, which, of course, is where Inheritance Tax planning comes in!

Inheritance Tax, as we know it today, arrived in 1986, the brainchild of Margaret Thatcher and her then Chancellor, Nigel Lawson. The tax is actually little more than a re-branding of its predecessor, Capital Transfer Tax, which, in turn, had replaced the earlier and rather more Draconian Estate Duty that, in its day, had played a major part in turning many of Britain's stately homes into amusement parks!

It is quite ironic that Inheritance Tax should have such a long lineage because it is, of course, usually one's descendants who will suffer its effects.

The principal difference between Inheritance Tax and its predecessors is the fact there is a general exemption for most lifetime transfers to other individuals. This is part of the reason behind accusations the Labour Party once made to a previous Conservative Government that they had allowed Inheritance Tax to become a voluntary tax, paid only by the unwary, ill-advised and unprepared taxpayer, while wealthier taxpayers took expensive professional advice and avoided the tax.

Certainly there was, and still is, an element of truth in this accusation. In recent years, however, it has become increasingly difficult to avoid this hated grave-robber's tax, with a host of measures introduced by Governments of all persuasions designed to block many of the popular methods used by families attempting to plan for the inevitable.

Help seemed to be at hand in 2007 when the Conservatives proposed a massive increase in the nil rate band exemption to £1m. Although this did not materialise for many years and, even then, it had been watered down beyond all recognition by a host of 'ifs', 'buts' and 'maybes', it did at least prompt the then Labour Government into making nil rate bands transferable between spouses. Suddenly, overnight, it seemed almost every married couple, civil partnership, widow, widower and surviving civil partner had effectively doubled their nil rate band.

Since then, however, things have taken a turn for the worse: as it seems all our politicians are happy to break their promises when it comes to

Inheritance Tax. Alistair Darling kicked off the era of broken promises in 2009 when he announced the planned increase in the nil rate band set for the following year would not go ahead. Worse still, he went on to announce a five year freeze in the nil rate band at its 2009 level of £325,000.

Soon afterwards, the Conservatives became the senior partner in the Coalition Government. Sadly, their promised increase in the nil rate band was swiftly shelved and Labour's freeze adopted in its place. Since then, the freeze has been extended several times, most recently by current Chancellor, Jeremy Hunt. In his November 2022 Autumn Statement, he announced a further, additional two-year freeze, bringing it to a total of nineteen years!

Incredibly, we are now stuck with the 2009 nil rate band of just £325,000 until at least 2028. Not since 1946 has it remained the same for so long.

Inflation has already severely eroded the value of the nil rate band and its real value will reduce even further between now and 2028. This will undo most, if not all, of the benefit of the transferable nil rate band regime introduced in 2007 (and those who are single or divorced never had that benefit anyway).

Make no mistake about it: the nineteen-year freeze in the nil rate band is a significant tax-raising measure. As the value of the band decreases in real terms, the Government's Inheritance Tax take is steadily increasing.

On top of the many broken promises about the nil rate band, George Osborne unleashed more misery in 2013, when he introduced a raft of new rules to restrict the deduction of liabilities. As one might expect, these blocked a number of popular planning techniques. However, what will be less apparent to most people is that the rules also lead to some astonishingly unfair results, especially when a family business is passed on to the next generation.

We will look at the impact of these rules in more detail later, but it is clear to me they severely undermine the original intention of helping small and medium-sized businesses survive their owner's death. The additional Inheritance Tax burden placed on many families will inevitably threaten many businesses' chances of survival.

In 2015, Osborne finally returned to that promise of a £1m nil rate band. And what a mess he made of it! Instead of the simple £1m nil rate band he had promised, he created an additional 'residence nil rate band'. Claiming the new relief amounted to the equivalent of a £1m nil rate band, "Promise Made, Promise Delivered!" was somewhat disingenuous, since getting the required level of exemption necessitates a complex combination of circumstances.

What Osborne did was rather like me promising to give one of my children £1,000 tomorrow, no strings attached; but, instead of doing as I said, waiting thirteen years then telling them I would give them £1,000, but only if they got married, bought a house, and provided me with grandchildren. That's what I call, "Promise Made, Promise Broken."

Despite the many changes to the Inheritance Tax regime, what remains true to this day is the fact it is the moderately wealthy members of society who suffer the greatest proportionate burden.

The problem for many people in the middle wealth bracket is they face a fundamental dilemma. On the one hand they have, on paper, sufficient wealth to leave their family with a substantial tax burden. On the other hand, they do not really have a great deal of disposable income, despite leading reasonably modest lifestyles. This means the simple expedient of just giving all their surplus wealth away is, in practical terms, simply not an option.

This all too common 'asset rich/cash poor' situation that many people find themselves in is exacerbated by increases in property values over recent decades, which have pushed more and more people into the Inheritance Tax bracket. Despite Osborne's desperately convoluted attempt at deluding us into thinking he'd fulfilled his promise, property values are still the number one cause of most people's Inheritance Tax burden.

As ever, there remain two effective ways to avoid Inheritance Tax: die poor, or plan ahead. Most of us find the first option somewhat unpalatable and also quite difficult to achieve without a remarkable sense of timing!

In the past, planning ahead was seen as the prerogative of the very wealthiest members of society, leaving the moderately wealthy to pick up the bill. However, my aim in this guide is to help put an end to this situation. If the Government is still prepared to allow Inheritance Tax to be even partly 'voluntary', albeit to a far lesser extent than previously, then why should ***anyone*** volunteer?

Early and careful planning is the key to reducing the eventual Inheritance Tax burden on your family and you don't need to be a millionaire to do it. Or to ***need*** to do it either, for that matter! Besides which, a great many people are surprised to discover when they add up all their assets they are, in fact, millionaires anyway: on paper, at least.

While some tax can still be saved through last-minute planning, a great deal more unnecessary tax can be avoided by planning for death and taxes throughout your lifetime. Read on and I will show you how.

1.3 GUIDE OVERVIEW

In this opening chapter, we start by taking a brief look at some background issues important to an understanding of the rest of the guide, including giving consideration to the future of Inheritance Tax and what it may mean for you and your family.

Following that, in Chapter 2, we will cover some of the basics, including how the tax is calculated and who pays it. All of this comes under the general heading of 'know your enemy', because it is important to understand what you're up against before you start to make plans to combat it.

We then move on, in Chapter 3, to look at the main exemptions available at any time, both during your lifetime and on death; as well as those only available on death.

Chapters 4 and 5 look at the area of lifetime transfers, including the additional exemptions available and how to maximise them.

The first five chapters prepare us for Chapter 6, which is devoted to Inheritance Tax planning for married couples, widows, and widowers (including civil partners). The changes introduced in 2007 fundamentally altered the Inheritance Tax planning landscape for married couples. In many cases, something that was the best advice before is now the very last thing you should do!

Married couples therefore need to consider everything contained in the rest of this guide in the context of the guidance set out in Chapter 6. The chapter also includes an analysis of the position facing widows and widowers, with guidance on crucial tax-saving action that needs to be taken by the recently bereaved.

Even those who are currently single or divorced will benefit from Chapter 6, as it includes guidance on the potential Inheritance Tax benefits of marriage.

Chapter 7 covers the important area of business property relief, perhaps the most valuable piece of equipment in our Inheritance Tax planning armoury; as well as agricultural property relief, which can also be highly beneficial.

We then move into the realm of trusts in Chapters 8 and 9 and we will see what powerful tools these vehicles can provide in the battle against Inheritance Tax.

In Chapter 10 we look at the tremendous opportunities pension savings can provide to allow your wealth to escape Inheritance Tax and be passed to your heirs, or even further down the generations, tax efficiently. However, there are also pitfalls to be wary of, and we will see that avoiding Inheritance Tax is only part of the story, as there are both other tax benefits, and other tax costs, to watch out for.

Chapter 11 builds further on this all-important broader view by reminding us there is a bigger picture than merely saving Inheritance Tax, and here we widen our sights to take in other aspects of estate preservation. This is reinforced in Chapter 12 with a look at the interaction between Inheritance Tax and Capital Gains Tax.

In Chapter 13, we look at passing on the family home. Here we will take a detailed look at some of the practical implications of the residence nil rate band, as well as some of the other planning techniques available to shelter the family home from the Government's most despised form of taxation.

Chapter 14 focuses on the powerful long-term planning strategy of family investment companies, which has the potential to save landlords and other

investors millions of pounds in Inheritance Tax. After that, in Chapter 15, we look at some other more advanced planning techniques.

In Chapter 16, we cover perhaps the most drastic of all planning techniques, with a guide to emigration, as well as a look at the advantages available to those who have successfully achieved it.

Chapter 17 provides a useful whole life timetable for effective Inheritance Tax planning, which puts everything we have learned into context and also reassures us, while it's never too early to start planning, it's never too late either!

Chapter 18 covers the planning a bereaved family can still carry out even after someone has died. While this is not the ideal time for truly effective Inheritance Tax planning, it is surprising how much can still be achieved if the deceased's family acts quickly.

This extensive guide, fully updated for the drastic changes introduced over the last few years, and the latest planning ideas available today, has something of value for everyone, and provides a valuable tool in the battle against the Government's most despicable form of taxation.

1.4 TERMINOLOGY, ABBREVIATIONS, AND EXAMPLES

Throughout this guide, you will see me refer to 'married couples' and 'spouses', as well as 'widows' and 'widowers'. In each case, the tax treatment applies equally to married couples of all types and to civil partners.

Any references to 'married couples' should be taken to also include registered civil partnerships; any reference to the taxpayer's 'spouse' will also include their civil partner where relevant; and any reference to 'husbands' or 'wives' will include spouses of the same gender and civil partners. Similarly, any reference to 'widows' or 'widowers' includes surviving civil partners.

For the avoidance of doubt, I would, in particular, point out the spouse exemption covered in Section 3.3 and all the planning issues covered in Chapter 6 apply equally to same sex spouses and civil partners. However, it remains important to remember, unless specified to the contrary, the tax treatment being outlined applies to legally married couples and legally registered civil partners only.

Inheritance Tax, like many other UK taxes, is administered by reference to the UK tax year, i.e. the period of twelve months ending on 5th April. Thus, for example, the 2023/24 tax year is the year ending 5th April 2024. References to the 'tax year' in this guide should be construed accordingly.

Other periods are also important for Inheritance Tax purposes and a reference to 'seven years' or 'more than two years', for example, means a strict period of calendar years rather than tax years.

Trust concepts and terminology are key to an understanding of Inheritance Tax planning. As well as the various types of trust, we will encounter important concepts such as 'interest in possession' and 'life interest'. A full explanation of trust terminology will be given in Chapter 8.

Another important concept in Inheritance Tax is 'domicile'. Broadly speaking, domicile is similar to nationality and for most people it will be obvious whether or not they are UK domiciled. Nevertheless, this analogy is not entirely accurate and domicile can sometimes be a highly complex matter. We will return to a detailed examination of this concept in Chapter 16.

Long-term UK residents and certain other individuals are also deemed to be UK domiciled for tax purposes. We will look at the rules governing deemed domicile in Section 16.3. Throughout the rest of this guide, unless specifically stated to the contrary, any reference to a UK domiciled individual includes those who are deemed UK domiciled. Similarly, a non-UK domiciled individual means someone who is neither UK domiciled under general principles nor deemed UK domiciled.

In legal terms, the word 'property' has a wide application and can mean any form of asset, including cash. Sometimes though, when we talk about 'property' we mean land and buildings: legally termed 'real property'. In this guide, I will use the word in both its common meaning and its legal meaning, and leave the context to make it clear which I mean on each occasion.

Life expectancies quoted throughout this guide are as per the Office for National Statistics (ONS). Naturally, these take no account of personal circumstances.

Throughout the guide I have allowed myself a few abbreviations. Some of them, like 'UK', are in common usage. I will explain what the others mean the first time I use them and they are all set out again in Appendix D for ease of reference. Large amounts, such as £1,000,000 or more are abbreviated by use of the letter 'm'. For example, £2,500,000 will be written as '£2.5m'.

Ignorance is Bliss

For the sake of illustration, throughout this guide I am generally going to ignore the following, which have become too small to have any significant impact. They will, however, produce small savings in practice, where relevant:

- The Capital Gains Tax (CGT) annual exemption (£6,000 for 2023/24; £3,000 thereafter)
- The dividend allowance (£1,000 for 2023/24; £500 thereafter)

Which Annual Exemption?

Confusingly, from 2024/25 onwards the annual CGT exemption and annual exemption for IHT will be the same amount: £3,000. They are, however, two completely different exemptions, operating in completely different ways, for different taxes. Throughout this guide, unless expressly stated to the contrary, any mention of the annual exemption means the annual exemption for IHT, covered in Section 5.2.

Property Taxes
Inheritance Tax planning often involves the transfer of UK property. This will sometimes lead to tax charges arising on the transfer in the form of some variation of Stamp Duty. The type of Duty arising will depend on which part of the UK the property is located in, as follows:

England:	Stamp Duty Land Tax (SDLT)
Scotland:	Land and Buildings Transaction Tax
Wales:	Land Transaction Tax
Northern Ireland:	Stamp Duty Land Tax (SDLT)

The rules applying under each form of Duty are broadly similar. There are some variations in the rates, however. Details of the rates applying to all UK property are included in the Taxcafe guide *How to Save Property Tax*.

For the sake of simplicity, I will refer only to SDLT throughout the rest of this guide, but similar charges will arise on property in Scotland or Wales, except the Duty will have a different name and will be charged at different rates.

About the Examples
This guide is illustrated throughout by a number of examples. Unless specifically stated to the contrary, all persons described in the examples in this guide are UK resident and domiciled for tax purposes.

In preparing the examples I have assumed the UK tax regime will remain unchanged in the future except to the extent of any announcements already made at the time of publication. However, if there is one thing we can predict with any certainty, it is that change **will** occur. The reader must bear this in mind when reviewing the results of the examples.

1.5 WHY WORRY?

Of course, ***you*** won't actually have to pay the Inheritance Tax (IHT) on your own estate. Furthermore, for many people, everything can safely be left to their spouse free from IHT.

And if you have no other dependants or potential beneficiaries but just resent paying any unnecessary tax, you can simply leave it all to charity.

But most people ***do*** have someone they care about. Usually they have children, other family, or friends whom they want to see benefit from the assets they have built up in their lifetime and they don't want to see the Government taking 40% of it away.

Even if, in the first instance, you are leaving everything tax free to your surviving spouse, your accumulated wealth will eventually be hit by IHT if you don't plan ahead.

As we will see later in the guide, you need to take action ***now*** to safeguard your family's future prosperity. Alternatively, you may be the potential

beneficiary yourself, trying to get an elderly relative to plan for the preservation of ***your*** inheritance. Either way, there is plenty to worry about!

But Am I Wealthy Enough to Worry?

Most people are quite surprised to discover just how much they are actually worth. How often have you heard someone say, "I'm worth more dead than alive"? Very often, especially as we get older, it's true (in pure financial terms only, of course).

This is basically because it takes an enormous amount of capital just to support one person. When that person dies, the capital that was previously tied up in supporting them is freed (after the Government gets its share!)

Hence, although you may not feel particularly wealthy, you may still find you have a large potential IHT bill. You'd be amazed just how many 'paper millionaires' there are these days. Take a look at this example:

Example: *Rosemary is a divorcee with no children of her own: although she is very close to her two younger sisters and their children. She owns a fairly average sized detached house, which her ex-husband transferred to her under the terms of their divorce settlement. The house is bigger than she really needs, but she has fond memories of the many holidays her nephews and nieces spent there, so she is quite attached to it. She has been advised its current market value is £550,000.*

Rosemary is retired and lives off her savings and an investment portfolio she managed to accumulate after her divorce. Although these produce an annual income of only £20,000, their total value is approximately £430,000.

Rosemary also has some jewellery, some silver, and a few antiques. Altogether, these are worth £15,000. Lastly, she has a small car, worth £5,000.

Nobody would call Rosemary rich by any stretch of the imagination. She's living off only £20,000 a year. But add it all up and you will find she is a millionaire. This means Rosemary's family has a potential IHT bill of £270,000!

And you don't need to be anywhere near as 'wealthy' as Rosemary to have an IHT problem. Once your estate is worth over £325,000, you have a potential exposure to tax at 40% on the excess (subject to any transferable nil rate band: see Chapter 6; and any available residence nil rate band: see Section 3.4). £325,000! What's that these days? A house, a car, a few savings, and you're easily there!

So, yes, generally speaking, if you can afford to buy this guide, there is a strong chance you are wealthy enough to worry about IHT!

1.6 A GUIDE TO EFFECTIVE INHERITANCE TAX PLANNING

All tax planning needs to be undertaken carefully and in full knowledge of the circumstances of the taxpayer's individual situation. This is probably

never more true than in the case of IHT, where a detailed review of the individual's situation is vital.

In this guide, I have provided a detailed examination of current IHT law on the basis of our present understanding. However, it is important to understand that further changes or restrictions could be introduced at any time and the precise meaning of some areas of law will only become apparent when tested in court: possibly many years from now.

I have highlighted some of the more popular planning techniques currently being used successfully by taxpayers wishing to protect their wealth from the scourge of IHT, or which are at least currently believed to work.

HM Revenue and Customs (HMRC) does, however, have very wide powers to enable it to closely examine any IHT planning technique and will do its utmost to overturn any planning strategy when the law permits it to. The associated operations rules and general anti-abuse rule covered in Section 11.11 are both particularly wide-ranging in this regard.

For these and many other reasons, the reader must bear in mind the general nature of this guide. Individual circumstances vary and the tax implications of an individual's actions will vary with them. It is always vital to get professional advice before undertaking any tax planning or other transactions that may have tax implications.

The Challenge

The great challenge with IHT planning is that much of the position will only be determined when an individual dies. Hence, since IHT law is constantly changing, no-one can be sure of having avoided this evil tax until they are safely tucked up in their grave!

For most people that will be many years from now, so there is plenty of time for the Government to move the goalposts, which means we have to keep an eye on them all the time. None of this means you shouldn't undertake IHT planning, especially given that the earlier you start, the more you are likely to save. But it does mean, in addition to taking professional advice when putting your plans into effect, you should also commission a regular professional review to determine whether your planning remains effective. Every IHT planning technique runs the risk of being undermined by changes in the law and these can happen at the stroke of a pen: especially when there is a change of Government.

In fact, it may not even be IHT you are trying to avoid. In January 2020, an all-party parliamentary group on 'inheritance and intergenerational fairness' published a report calling for some radical changes to the UK's death tax regime, including replacing IHT with a 'Death Tax' and lifetime 'Gift Tax'.

The current Government has shown no interest in these proposals, but it is possible a future Government might adopt some of them. Or it may do something completely different; or simply carry on tinkering with the current regime, as every Government for the last forty years has done.

Personally, I think taxing death, or personal gifts between family members, is completely immoral and just plain wrong. If it was up to me, IHT would be abolished tomorrow. However, I'm sorry to say that looks unlikely in the foreseeable future, regardless of what Government we are lumbered with.

We cannot predict what exactly is going to change. But I am sure something will. So, while death is certain, the tax regime you will face is not. Despite this, early and effective IHT planning is still the best way to protect your family, whatever the future may hold.

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