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Inheritance tax primer pack

Inheritance tax (IHT) is the tax we least like to think about. But your family and other beneficiaries could lose a lot of money unnecessarily to IHT, purely through lack of planning. Use this checklist to prepare for your meeting with an adviser, to maximise the amount your loved ones will receive.

Understanding IHT

Not everyone's estate will be hit by IHT. The first £325,000 of assets are inherited tax free – this is called the nil-rate band. But everything above this band is taxed at 40 per cent. The tax is either deducted from your estate or paid by your beneficiaries (for example, if they inherit a house and want to keep it, they must still pay tax on the appropriate portion of its value).

To reduce your exposure to IHT, you first need to know what that exposure is. This means working out the total value of your estate – your net worth. We'll do this first.

What are you worth?

Your net worth is everything you own (except most pensions, which are usually exempt from IHT) minus everything you owe. Remember that assets will include anything of value, including payments yet to be made such as life insurance pay outs and money that you yourself may inherit. Similarly, deductions can include payments you have yet to make, such as funeral expenses.

What I own

- Savings £
- Investments £
- Property £
- Vehicles £
- House contents £
- Life insurance pay outs (if not in trust) £
- Other possessions or assets £
- Likely inheritance (from others) £

Total: £

What I owe

- Remaining mortgage £
- Credit card debt £
- Loans £
- Overdrafts £
- Other credit agreements £

Total: **£**

Now subtract the second total from the first to find your net worth.

Net worth: £

Finally, subtract £325,000 (the nil-rate band) from your net worth to find your net estate.

Net estate: £

This is the amount that is exposed to IHT at 40 per cent.
To make a start on reducing the potential loss to tax, continue to the next section.

Planning for IHT

It may sound obvious, but to plan effectively for IHT you need to know who will inherit from you. Remember, you don't pay IHT – your beneficiaries do. Taking action in advance can save your family and friends a lot of money and hassle.

Think about your circumstances

	Yes	No
• Are you married / in a civil partnership?]	○	○
• If No, are you cohabiting?	○	○
• Do you jointly own any large assets (e.g. property)?	○	○
• Have you ever been widowed?	○	○

Good to know: If your spouse or civil partner dies, any unused nil-rate band can be transferred to your estate. This applies even if you remarry. This means your estate can be worth up to £650,000 before any IHT is due.

• Do you have children?	○	○
• If so, do you want them to inherit directly from your estate?	○	○
• Do you expect to name other beneficiaries outside your immediate family?	○	○
• Have you made a will and is it up to date?	○	○

Good to know: Don't assume a will is unnecessary if you're leaving everything to your immediate family. Under intestacy law, children may be entitled to a share of the estate, but are subject to IHT whereas a spouse is not. A will that leaves your whole estate to your spouse can at least defer IHT.

Also remember that an unmarried, cohabiting partner has no automatic right to inherit anything from you – so it is even more vital to make a will.

Think about your assets

	Yes	No
• Do you have a pension that is not converted into an annuity?	◯	◯
• Do you know its current value?	£	
• Do you have other (non-pension) savings?	£	
• Could your non-pension savings provide you with an income in retirement?	◯	◯

Good to know: Ordinary savings are subject to IHT, but any unused money in a pension pot can usually be passed on free of IHT (though income tax may apply). It may therefore be more efficient to fund your retirement with other savings first if you can, and spend your pension last of all.

• Is your current income more than you need to live on?	◯	◯
• Do you own any assets that you could now live comfortably without (e.g. property, valuables, additional vehicles)?	◯	◯
• Do you have life insurance?	◯	◯

Good to know: Life insurance pay-outs normally form part of your estate, so are subject to IHT. Ask an adviser about arranging your life insurance to pay into a trust, which will place it outside of your estate and make the payment tax free. You can even take out life insurance specifically to cover the costs of IHT.

Think about what you can do now

• Are you in a position to make gifts of cash or other assets to your intended beneficiaries?	◯	◯
• Would the gifts total more than £3,000 per year?	◯	◯
• Are any of your beneficiaries likely to marry in the near future?	◯	◯

Good to know: You can make gifts of up to £3,000 per year free of IHT (this is called your annual exemption). Wedding gifts are also exempt: up to £5,000 to a child, £2,500 to a grandchild or great-grandchild, and £1,000 to anyone else. You can also give up to £250 a year to anyone who has not received either of the other IHT-free gifts from you.

Notes

- Are you reasonably confident you will live for at least another seven years? Yes ○ No ○

Good to know: Larger outright gifts than those described above are known as potentially exempt transfers (PETs). These become free of IHT if you live for at least seven years after making them. If you die sooner, then IHT may be payable on the gift. Special rules apply for gifts placed in trust – ask your adviser.

- Do you plan to give to charity in your will? ○ ○

Good to know: Donations to charities are free from IHT. Furthermore, if you donate 10 per cent or more of your net estate to charity, the IHT on the remainder falls from 40 per cent to 36 per cent.

- Have you completed an expression of wish form to tell your pension provider who you would like to receive your fund/benefits if you die? ○ ○

Good to know: Your pension scheme will not normally be bound to follow your expression of wish. They will pay at their discretion, but will take your wishes into account. It is this discretion which means your pension death benefits are normally free of IHT.

Notes

Now speak to an adviser

Inheritance tax is a complex area which generally requires professional advice. Your completed checklist should help you understand your exposure to IHT and let you start to think about potential ways to reduce this. Bring this checklist along when you meet your financial adviser.

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