



ST. JAMES'S PLACE  
WEALTH MANAGEMENT

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INHERITANCE TAX

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PARTNERS IN MANAGING YOUR WEALTH



## INHERITANCE TAX – AN INTRODUCTION



Death duties have been with us for centuries, in the guise of Estate Duty, Capital Transfer Tax and now Inheritance Tax (IHT). Irrespective of the name used, the purpose has always and will always be the same; to raise revenue from the estates of citizens.

Once considered a tax on the truly affluent, IHT now affects more estates than ever. It will undoubtedly come as a shock to discover that a large proportion of your wealth, which includes all of your assets such as the family home, investments including Individual Savings Accounts (ISAs), life assurance plans not in trust, and even old family heirlooms might actually have to be sold in order to meet the tax liability on death.

The first £325,000 of an individual's estate (referred to as the nil rate band) is taxed at 0% and is not therefore liable to IHT. The entire estate in excess of the nil rate band is taxed at a flat rate of 40% assuming no charitable bequests. The table below shows the effect this tax can have on an estate and how HM Revenue & Customs (HMRC) could easily become the single largest beneficiary.

SIZE OF ESTATE	AMOUNT OF TAX PAYABLE	% OF ESTATE PAID IN TAX
£325,000	Nil	0
£500,000	£70,000	14%
£750,000	£170,000	23%
£1,000,000	£270,000	27%
£1,500,000	£470,000	31%

From 6 April 2017, each person got an additional tax free allowance to use against the value of their estate if their home or former home is passed to a direct descendant. This additional allowance is known as the Residence Nil Rate Band (RNRB). From 6 April 2019, the RNRB amounts to £150,000\* for an individual (rising to £175,000 by 2020/21).

*\* Will be reduced for estates in excess of £2m*

*Note: For married couples and civil partners any unused portion of the nil rate band – or residence nil rate band – may be transferable from the first to die to the survivor.*



*Transfers between UK domiciled spouses or civil partners, during lifetime or on death, are exempt from IHT*

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## WHO IS LIABLE?



All individuals domiciled in the UK are subject to IHT on ‘transfers of value’ of all their worldwide assets with the exception of excluded property – see below. Those who are not UK domiciled are usually only subject to IHT in respect of their UK assets and any offshore assets (such as shares in an offshore company) that derive their value from UK residential property. The domicile of an individual is generally the country where he or she permanently resides or intends to remain in the future – often referred to as ‘where your heart is’.

There is also the concept of ‘deemed domicile’, which now applies for all tax purposes including IHT purposes:

- the individual is not UK domiciled but has been resident in the UK in 15 out of the last 20 tax years. For IHT purposes only, there is a further requirement that the individual was resident in the UK for at least one of the four preceding tax years.

## EXCLUDED PROPERTY

Certain assets are excluded from IHT. These include:

- Some interests under a trust.
- Assets not situated within the UK except to the extent that they derive their value from UK residential property. However, the individuals beneficially entitled to these assets must be domiciled outside the UK or the assets must be held in a trust created at a time when the person who created the trust (the settlor) was not UK domiciled.

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## WHAT IS A TRANSFER OF VALUE?



A transfer of value for IHT purposes is any action or omission (usually a gift) in relation to your estate, which reduces its value. This can be during your lifetime or on death. It is not necessarily measured by the value of the asset gifted. It is calculated by reference to the loss to your estate, i.e. by looking at the value of the estate before, and after, the gift is made, in order to calculate the loss and therefore the value transferred.

Transfers of value will be one of three types:

- Exempt Transfers. These are transfers where IHT will never be payable.
- Potentially Exempt Transfers (PETs). These become exempt if the donor survives seven years from the date of the gift.
- Chargeable Lifetime Transfers (CLTs). These may result in an immediate lifetime charge to IHT of 20% (25% where the liability is met by the donor).

## EXEMPT TRANSFERS



### TRANSFERS BETWEEN A HUSBAND AND WIFE OR CIVIL PARTNERS

Transfers between spouses or civil partners, during lifetime or on death, are exempt from IHT. For the exemption to apply a couple must be legally married or in a registered civil partnership. It does not apply to 'common law' partners, although there is no requirement for a married couple to be living together.

Where a transfer is being made by a UK domiciled individual to a spouse or civil partner who is not UK domiciled the exemption is limited to a lifetime cap of £325,000.

### ANNUAL AND SMALL GIFT EXEMPTIONS

Gifts of up to £3,000 per tax year are exempt. This exemption is per donor and, if not used in any tax year, can be carried forward for use in one subsequent year only. An unlimited number of smaller gifts – worth £250 or less – can also be made to any number of people, however, not to the same person who has benefited from the annual exemption.

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## NORMAL EXPENDITURE OUT OF INCOME EXEMPTION

Regular gifts by an individual that are made out of genuine income are exempt. Gifts will only fall within this exemption if they do not affect the donor's standard of living (i.e. they must be made out of surplus income) and they should be part of a regular pattern of spending. For example, using income to fund the contributions to a life plan held in trust.

## GIFTS FOR MAINTENANCE OF A DEPENDANT EXEMPTION

A lifetime gift of capital designed to maintain a dependant is exempt, provided payment is for:

- The maintenance of a spouse or former spouse.
- The maintenance or education of a dependent child or stepchild under the age of 18 (or over 18 if in full-time education).
- Reasonable provision for the care or maintenance of a dependent relative who is unable to maintain him or herself due to disability or infirmity.

## GIFTS IN CONSIDERATION OF MARRIAGE OR REGISTRATION OF CIVIL PARTNERSHIP

Parents can each give up to £5,000 to their child of the marriage/civil partnership. In addition, the grandparents may each give a sum of up to £2,500 to each grandchild. Anyone else may give £1,000.

## GIFTS TO RECOGNISED UK CHARITIES AND OTHER BODIES

Gifts to charities, political parties or gifts for the public benefit, e.g. universities, national museums, the National Trust etc are also exempt.

## POTENTIALLY EXEMPT TRANSFERS

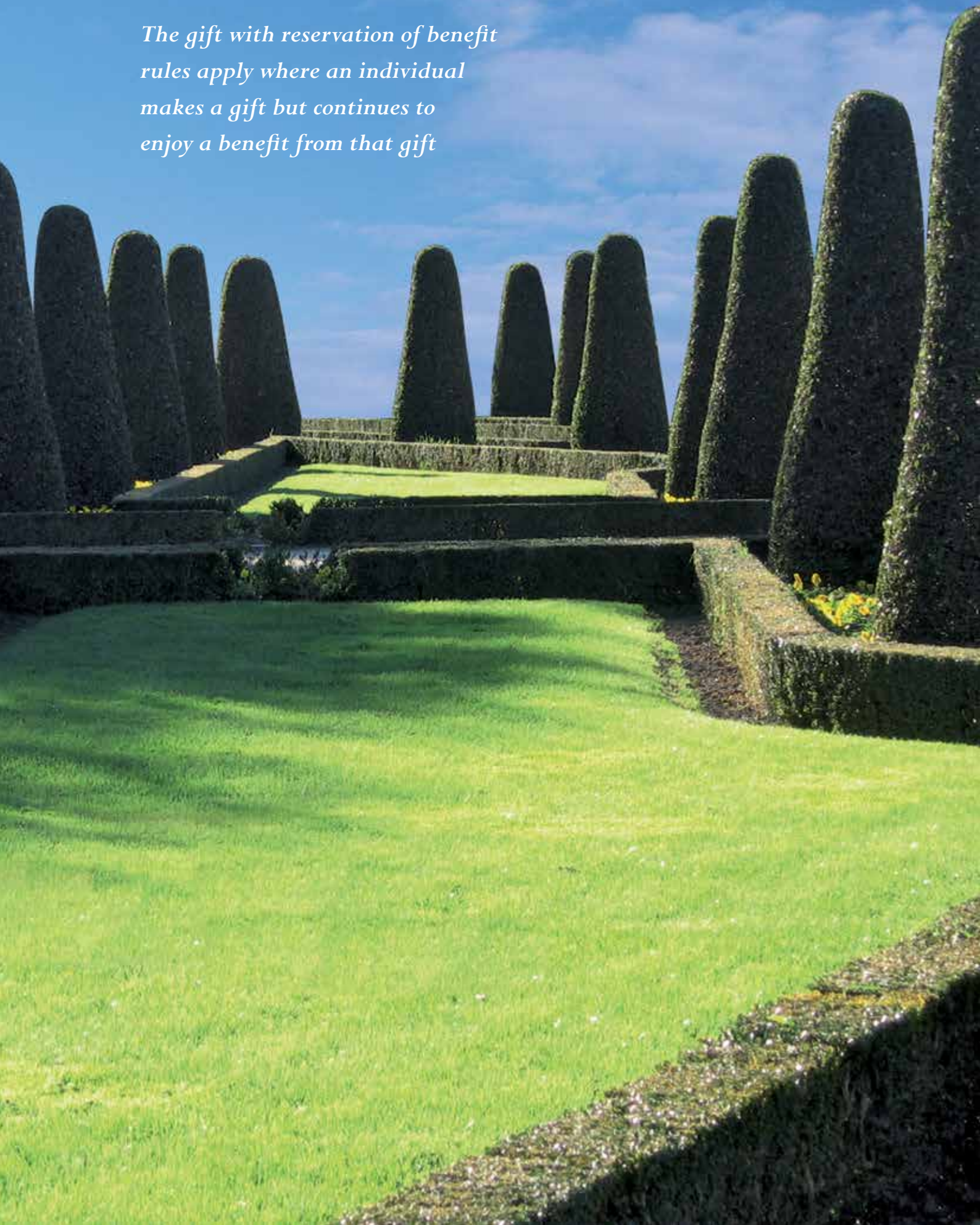


It is possible to make transfers which are PETs, which include:

- Outright gifts to an individual.
- Transfers into a bare trust (St. James's Place Absolute Trust).
- Transfers into a disabled trust.

No tax will be payable when the gift is made since it is treated as exempt and remains so, provided the donor survives at least seven years following the date of the gift. Should death occur between years three and seven after the gift, IHT may become payable, but at a tapered rate – see page 13. In all cases, however, any increases in value of the asset gifted from the date of the gift will be free from IHT.

*The gift with reservation of benefit rules apply where an individual makes a gift but continues to enjoy a benefit from that gift*





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## CHARGEABLE LIFETIME TRANSFERS



CLTs are transfers that do not qualify as being exempt or potentially exempt, the most common example being a gift into a trust (excluding bare trusts). Although immediately chargeable, tax will only be payable at the lifetime rate of 20% (25% where met by the donor) where the value of the transfer, when added to other CLTs in the previous seven years, exceeds the nil rate band and any available exemptions. So, for example, on a gift of £350,000 to a discretionary trust (assuming the annual exemption has been used elsewhere), provided no similar transfers had been made in the preceding seven years, the tax charge, if paid by the trustees, would be:

£325,000 at 0% = £0

£25,000 at 20% = £5,000

## GIFTS AND TRUSTS



If you wish to make a gift to a minor or someone you do not believe is sufficiently responsible, you may wish to make the gift but keep control over it, either until the beneficiary reaches a certain age or until you decide that the recipient is sufficiently mature. This can be achieved by using a suitable trust. Further reasons for using a trust would include:

- Provision of monies for successive generations.
- Preservation of monies which may otherwise be diluted or pass outside of the family due to divorce or bankruptcy of a beneficiary.
- Income Tax and/or Capital Gains Tax (CGT) mitigation.
- Mitigation of IHT.
- Avoidance of delays in obtaining a Grant of Probate.

Trusts cannot be ignored as they are a fundamental part of estate planning. They can help in the process of reducing or mitigating IHT but are also commonly used in helping provide for any liability. The IHT treatment of trusts at inception, during the term of the trust period and upon distribution of any trust funds, depends on the type of trust used.

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## LIFETIME GIFTS



There are three important issues that must not be overlooked when considering lifetime gifts; the ‘gift with reservation of benefit rules’; CGT and pre-owned assets tax.

### GIFT WITH RESERVATION OF BENEFIT

The gift with reservation of benefit rules apply where an individual makes a gift but continues to enjoy a benefit from that gift, for example, continuing to take an income from an investment or continuing to live in a property that has been given away. The rules also apply if you make a gift into trust and do not exclude yourself from the list of beneficiaries. Where there is a gift with reservation, there will be no IHT savings as the asset will be deemed to remain in your estate for IHT purposes even if you survive seven years from the date of the gift.

### CAPITAL GAINS TAX

A gift is a disposal for CGT purposes. When gifts are made between ‘connected persons’, such as parents and their children/grandchildren, the donor is treated as having made the disposal at full market value. Therefore (unless the assets are exempt from CGT), if the asset has increased in value since it was acquired, a CGT liability may arise for the donor(s) whilst perhaps trying to save IHT.

Not all assets are chargeable to CGT, for example cash, gilts and, under most circumstances, life assurance plans. In other cases, it may be possible to claim ‘holdover relief’, effectively deferring any CGT until a subsequent disposal by the donee. This may be beneficial where the trustees or beneficiary(ies) as donees pay CGT at a lower rate than the donor.

Where an individual dies holding assets that stand at a gain, although those assets will form part of the estate for IHT purposes, they will not be subject to CGT. They benefit from a ‘tax-free uplift’ to the value which applied at the date of death – often referred to as ‘rebasing’.

Clearly, if an individual had given the asset away shortly before death, they would have crystallised the CGT liability yet the asset may still be in their estate for IHT purposes. The loss of potential rebasing should be considered carefully against a potential IHT saving before making a gift. It is therefore imperative to seek advice before making the gift.

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## PRE-OWNED ASSETS TAX

The Finance Act 2004 introduced a new income tax charge, called pre-owned assets tax (POAT) which broadly applies to the continued use of previously owned assets. This means that, where an individual disposes of an asset and continues to benefit from it, it may be subject to POAT. The charge effective from 6 April 2005, where applicable, is based on the value of the asset or, in the case of property, on its market rental value. The POAT charge will not apply if the formerly owned asset continues to form part of the donor's estate as a gift with reservation.

## RELIEFS



Reliefs against IHT are available on certain types of asset. Business Relief, Agricultural Relief and the relief available for woodlands have changed over the years, but where they apply remain of exceptional value. The rationale behind these substantial reliefs is to try and ensure that family businesses or partnerships do not have to be split up and sold to pay a tax liability on the death of one of the principals. There are certain conditions which need to be satisfied and it is important not to take any action that would jeopardise such reliefs.

### BUSINESS RELIEF

This provides relief from IHT at rates of 100% and 50%. Reliefs are available as follows:

- Whole or part of an unincorporated business – 100%.
- Shares in an unquoted trading company – 100% (including Alternative Investment Market shares). It is possible to make investments specifically in order to qualify for Business Relief after holding the investment for two years. Alternative Investment Market share portfolios and Enterprise Investment Schemes (EISs) both qualify in this regard. EISs also offer the investor the opportunity to benefit from deferral and income tax relief. However, investors must be willing to accept a high level of investment risk – as the investments are made in small companies, some may not perform as well as the investor may hope, or may fail completely. An investor may not get back the amount invested. Furthermore, these types of investment are typically illiquid and investors must be aware that they may have difficulty, or may be unable to realise their shares at levels close to that which reflect the value of the underlying assets.
- A controlling share holding in a quoted company – 50%.
- Property used in a trade by a company controlled by the donor or partnership in which the donor is a partner – 50%.



*Life assurance plans are uniquely placed to provide a tax-free cash sum to meet any liability*

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## AGRICULTURAL RELIEF

Broadly, this is available at either 100% or 50%. In order to be entitled to this relief, the donor must have either occupied the property for the purpose of agriculture for at least two years before transferring it, or owned it for seven years with others farming it.

## WOODLANDS RELIEF

This is a special relief that applies to the growing of timber. The relief is only available on the value of the timber, with the land on which it is grown likely to benefit from Agricultural Relief. This relief allows the payment of IHT to be deferred until the timber has been sold.

## ADDITIONAL RELIEFS



### TAPER RELIEF

Taper Relief may be available should the donor die within seven years of making a transfer that is not exempt. The relief applies to reduce the IHT payable where the cumulative value of non exempt transfers in the seven years prior to death exceed the prevailing nil rate band. It is important to note that if the failure of the gift does not result in a liability to IHT (because the value of the gift is within the donor's nil rate band), taper relief will not be available.

### QUICK SUCCESSION RELIEF

As the term 'quick succession' implies, this relief is available to reduce the tax payable on death where the deceased died owning assets on which IHT was paid within the previous five years.

## PENSIONS



Under IHT legislation, pensions can play a considerable role in estate planning.

Although pension death benefits are exempt from IHT, if they are passed to your survivor they will form part of their estate. St. James's Place can offer solutions which allow your survivor access to your death benefits without them forming part of their estate.

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Income from a pension can provide greater flexibility in respect of the rest of your assets. If you can survive comfortably on your pension, you are able to consider making lifetime gifts of some of your capital. Alternatively, the pension income itself can be extended to benefit your dependants.

Please note that the value of an investment made through St. James's Place will be directly linked to the performance of the underlying funds or assets held and the value may fall as well as rise. You may get back less than the amount invested.

## LIFE ASSURANCE PLANS



There may be a number of reasons why it is not possible to reduce the size of your estate (and any potential IHT liability). Where this is the case, life assurance plans are uniquely placed to provide a tax-free cash sum on death to meet any liability. However, although life assurance plans provide cash on death, they may also form part of your, or your survivor's estate thereby actually increasing the IHT liability. It is therefore imperative that the plan is written into trust to avoid this.

The contributions to the life assurance plan will be transfers of value, but will usually fall within the normal expenditure out of income exemption or the annual exemption.

Where life assurance plans have already been established but are not held in trust and are no longer needed for their original purpose, these could be either assigned by way of gift or placed into trust thus removing them from your estate.

## WHO PAYS THE TAX AND WHEN?



On death, your Personal Representatives are liable for any IHT, which is normally due six months after the end of the month in which death occurs. Usually, the IHT liability must be met before a Grant of Probate can be issued. This can often mean that the Personal Representatives have to take out a loan to pay the tax.

Where IHT becomes due as a result of a lifetime PET becoming chargeable (where a donor did not survive seven years) it is either the recipient of the gift or the trustees (if the gift was placed into a trust) who is liable for the tax.

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For CLTs that exceed the nil rate band in any seven year period, lifetime IHT is due six months after the transfer unless the transfer was between 6 April and 30 September when the tax will not be due until the end of the following April.

## IHT AND YOUR PRIORITIES



Before any planning is undertaken, there are some fundamental considerations that should be incorporated into your strategy:

### BE REALISTIC

This cannot be over emphasised. Do not put tax savings as your prime motivation. IHT planning is about passing the proceeds of an estate to chosen beneficiaries rather than to HMRC. However, this should never be at the expense of maintaining an acceptable lifestyle.

### FLEXIBILITY

Make sure your arrangements are flexible as you may need to alter them in future due to changes:

- In your personal or financial circumstances.
- In, or the addition of, beneficiaries.
- In legislation or HMRC practice.

### KEEP THINGS SIMPLE

With the complexities involved with IHT, if a simple solution can be found, it will usually be the best one.

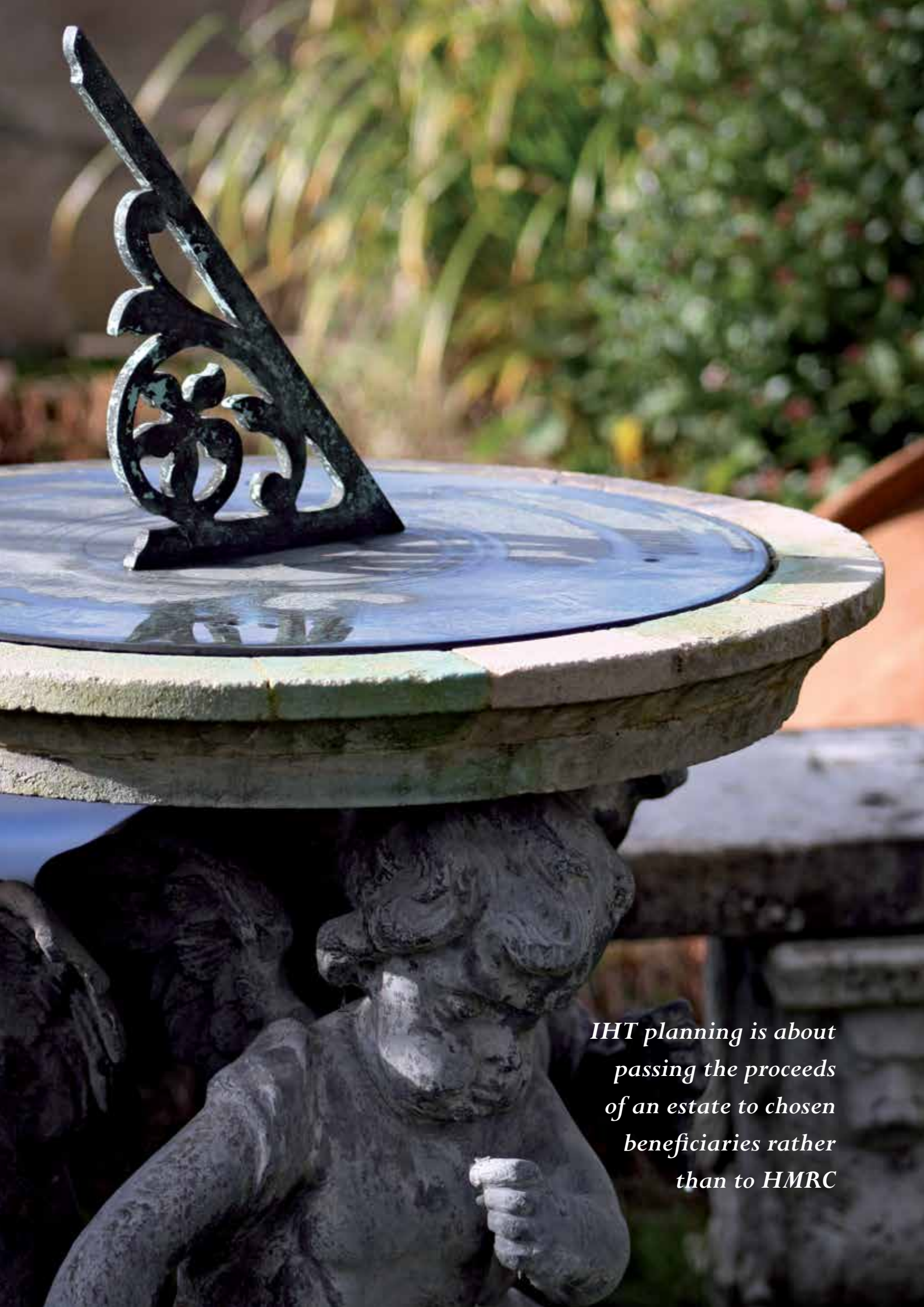
## TAXATION



The information in this brochure is based on our current interpretation of the law and HMRC practice.

The levels and bases of taxation and reliefs from taxation are generally dependent on individual circumstances.

Taxation legislation and HMRC practice may be subject to unforeseen changes in the future.



*IHT planning is about passing the proceeds of an estate to chosen beneficiaries rather than to HMRC*



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## MITIGATING A POTENTIAL IHT LIABILITY



As this brochure highlights, the area of IHT planning can be a complex one. However, the first step is to draw up a Will. It may be possible to mitigate IHT altogether simply by drafting a tax efficient Will. If you do not know whether your current Will is tax efficient or indeed valid, your St. James's Place Partner can arrange for it to be reviewed.

If you do not have a Will, or need to replace an existing Will, your St. James's Place Partner can also refer you to a member of the St. James's Place Legal Services Panel. The law firms on the panel have been chosen for the high calibre of advice they can offer.

Alternatively, you may require a series of solutions to combine IHT mitigation with other tax planning, without compromising your own lifestyle – whether that is by meeting an income requirement or perhaps ensuring funds are available for long term care fees, should care be required in the future. Solutions are available that also provide asset protection for your heirs.

Your St. James's Place Partner can consider your IHT liability and the most appropriate methods of addressing this, whatever your own individual circumstances.

Trusts, Wills and some areas of Inheritance Tax Planning are not regulated by the Financial Conduct Authority.

Will writing is a separate and distinct service to those offered by St. James's Place.

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## ABOUT ST. JAMES'S PLACE



At St. James's Place Wealth Management we offer a wide range of high quality wealth management services to both individuals and businesses.

At the heart of the business is the St. James's Place Partnership, a group of the most experienced, able and highly regarded professionals working in wealth management today. They are solely responsible for delivering the St. James's Place Wealth Management Service to clients. Members of the St. James's Place Partnership have on average 18 years' experience in the industry and build long term relationships founded on trust.

### YOUR PERSONAL WEALTH MANAGEMENT SERVICE

The essence of our business is to help make it easier for you to manage your wealth, and we achieve this through the provision of personal, face-to-face wealth management advice that is designed to suit your individual long term requirements. We can help address straightforward issues as well as resolve more complex multifaceted ones. Basing our service on this principle, our Partners have built exceptionally strong and trusted relationships with our clients.

We do not believe in off-the-shelf solutions, and our Partners know that every single client has their own unique personal concerns, responsibilities and ambitions. The solutions that work for one, may not necessarily work for another. This is why all our advice is face-to-face and focused on the personal needs of each individual client. Your St. James's Place Partner will work closely with you to offer solutions that are specifically tailored to you.

### OUR GUARANTEE

St. James's Place guarantees the suitability of the advice given by members of the St. James's Place Partnership when recommending any of the wealth management products and services available from companies in the Group, more details of which are set out on the Group's website, [www.sjp.co.uk/products](http://www.sjp.co.uk/products).

### NEXT STEPS

For further information please contact your St. James's Place Partner.





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