

KEY FEATURES AND BENEFITS 6

The Effects of Generational Inheritance Tax (IHT)

WHAT IS IHT?

IHT is often referred to as the Double Whammy! It is the continued application of Inheritance Tax on assets which are bequeathed to a Beneficiary and thus increasing their own personal wealth (estate). This may mean that IHT has to be paid again on the inherited assets on death and this will continue through future generations.

Who is affected? Everyone whose Will does not include Trusts and whose assets are passed to Beneficiaries.

Some examples of the effects of Generational IHT

Assuming the available Nil Rate Band (NRB) to currently be £325,000 at time of death and Residence Nil Rate Band (RNRB) of £175,000.

'Mr' dies leaving an estate of **£1 million** including his main residence with a value of £350,000. No gifts have been made in his lifetime. He leaves behind 1 daughter.

$£650,000 - \text{NRB } (£325,000) = £325,000.$

$£350,000 - \text{RNRB } (£175,000) = £175,000.$

IHT is now due on the £500,000 at 40% = **£200,000.**

Net estate now due to the daughter = £800,000 The Will leaves this estate to the daughter.

The daughter already has assets valued at the NRB (£325k) and has one son. So now her estate is valued at £325,000 (of which £175,000 is her main residence) + £800,000 inheritance from Dad = **£1,125,000.**

On her death, after the application of the RNRB (£175,000) and NRB here is a £625,000 excess subject to IHT @ 40% = **£250,000.**

So, in just two generations **£200,000 + £250,000** has been paid in Inheritance Tax. **A massive £450,000!**

Of the original **£1 million estate**, a mere **£550,000** remains for the grandson!

OUR SOLUTION



Dad writes Will incorporating Trusts for his £1 million estate.

No gifts made so net estate available for daughter will be £800,000.

3 Pilot Trusts (Trusts established in lifetime outside of the Will) established to receive 1/3 of net estate.

£266,667



Flexible Family Trust 1



£266,667



Flexible Family Trust 2



£266,667



Flexible Family Trust 3



Daughter and grandson are potential Beneficiaries of all three Trusts and grandson is 'default' IIP beneficiary for RNRB. None of whose assets held will become part of their estates for IHT, Care Costs or be at risk to future Divorce settlements, or Creditors.

So on the death of the daughter, of the original £1,000,000 estate £800,000 remains protected for future generations with a massive £250,000 saved to IHT alone!

A further example of the effects of Generational IHT.

Assuming the available NRB to currently be £325,000 at time of death. Assuming the RNRB is at the value of £175,000 (which will be effective from 2020).

Unmarried Couples - For IHT purposes Unmarried Couples are deemed to be single!

Mr Brown owns the home in his sole name valued at £400,000.

Ms Green has cash assets of £300,000 from the sale of her previous home.

Mr Brown also has a further £100,000 in cash.

Mr Brown dies (20/21 Tax year).

Mr Brown's estate is worth £500,000 - £325,000 (NRB) = £175,000 subject to IHT @ 40% (there is no RNRB qualification as Mr Brown is leaving his whole estate to a non-lineal descendant).

£70,000 falls due in IHT.

Mr Brown's Will left everything to Ms Green and then to his children.

Ms Green inherits a net estate of **£430,000**. Through her will she can leave assets to whomever she wishes, potentially disinheriting Mr Brown's bloodline children.

Ms Green dies...her estate is now worth **£730,000** and so is also subject to IHT.

$£730,000 - £325,000$ (NRB) = $£405,000 - £175,000$ (RNRB) = $£230,000$

Ms Green claims the RNRB as she is leaving to lineal descendants.

£230,000 @ 40% = £92,000 is now due in IHT.

So, on their original combined estate of £800,000, **£162,000 has been lost to IHT!**

The children inherit £638,000 which adds to their estate.

OUR SOLUTION

Will
£500k
Estate

Mr Brown

On his death there is NO IHT to pay.
Children are default IIPs for RNRB.

£250,000

Flexible Family Trust 1



Beneficiaries are partner and his children.

£250,000

Flexible Family Trust 2



Trust funds do not add to their partner's estates for IHT and are better protected from Care, Divorce Settlements and Creditors.

Will
£300k
Estate

Ms Green

No IHT payable.

Flexible Family Trust 1



Ms Green's children to benefit. Does not enter their estates and protected.

✓ So there is NO IHT to be paid! Our solution saves the client £162,000 in IHT.

Where a couple is married and they have assets above two RNRBs and two NRBs there will be IHT payable for the Beneficiaries on 2nd death without the correct planning. Assets should not be left to the Beneficiaries. Trusts should be established for both husband and wife and the estate equalised.

Prior to second death further planning can take place to reduce any IHT liability and the assets will not impact on the Beneficiaries own estates and give rise to further IHT.

Trusts can also protect the assets for the Beneficiaries from Care, Divorce and Creditors.

Even where assets held are below the available Nil Rate Band and no Inheritance Tax is due, assets should never be distributed to

a Beneficiary as this then adds to their own estates which may mean an IHT bill for their chosen Beneficiaries and leaves those assets assessable to their own Care Costs, attackable by Divorce Settlements and Creditors.

Due to changes announced in the July 2015 Budget, Multiple Trusts settled on the same day (for instance settled by a Will) will be subject to periodic and exit charges, even if the Trusts are set up on different days. Our advice remains, continue to use Multiple Trusts as there are various options open to Trustees following the death of a Settlor to reduce the occurrence of periodic and exit charges.

This sheet contains only general planning and is not to be construed as advice for any personal planning. Each strategy recommended is based on individual circumstances.