

## Introduction

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Inheritance tax (IHT) can have a significant effect on an estate. An individual who has a house, some savings and perhaps the proceeds of a life assurance policy can easily have an estate worth more than £325,000 – the figure above which IHT becomes chargeable for 2010/11. Without the right planning (see the separate topic 'Inheritance Tax Planning'), IHT can substantially reduce the value of the estate left to the beneficiaries in a will.

However, it is relatively easy to take some measures that mitigate IHT, particularly if action is taken early enough. This guide explains the possible impact that IHT can have on an individual's estate and briefly sets out some of the more straightforward ways in which it can be reduced.

IHT is highly complex and this guide is for general information only. For specific problems and individual planning, it is essential to obtain competent professional advice tailored to individual needs.

## The impact of IHT

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Inheritance tax is primarily a charge on an individual's net estate on death. In some circumstances, it is also charged on gifts made during an individual's lifetime.

### Tax rates

There is a nil-rate band, currently (2010/11) £325,000. Unless changed in the next budget, the nil-rate band will remain at this level until 2014/15. Husbands, wives and civil partners each have their own nil-rate band, which until 8 October 2007 could be used only by the individual to which it belonged. Now, when a person has died any unused nil-rate band can be transferred to the estate of a surviving spouse or civil partner who dies after 8 October 2007. It does not matter when the first death occurred.

The amount of the nil-rate band available for transfer is based on the proportion of the band that was unused when the first spouse or civil partner died. The same proportion of the amount of the nil-rate band in force on the death of the second spouse/partner is then accumulated with that spouse's own nil-rate band.

For example:

- If on the first death the amount chargeable to IHT is £120,000 and the nil-rate band at that date is £300,000, then 60% of the original nil-rate band would be unused and may be transferred to the surviving spouse.
- If the nil-rate band when the surviving spouse dies is £350,000, this would be increased by 60% to give a total of £560,000.

The amount of additional nil-rate band that any surviving spouse or civil partner can accumulate is limited to the value of the nil-rate band at the time of their death. Without such a restriction, a person might have been able to inherit more than 100% of the nil-rate band where surviving spouses or partners enter into a new marriage or civil partnership. The personal representatives of the estate of the second spouse or civil partner to die must make the claim for transfer of unused nil-rate band when they submit the IHT return. This new provision should be considered carefully when drawing up wills. It might also be appropriate to carry out a review of existing wills which may have been written to avoid the problem of a potential loss of the nil-rate band on the first death.

- The tax rate on death is 40% of the excess over the nil-rate band.
- Some lifetime transfers are taxed at a rate of 20% instead of 40%.

## Chargeable transfers

IHT is normally charged on:

- Assets that pass on death.
- Lifetime gifts made during the seven years before death, though a reduced rate of tax may apply to such transfers.
- Some lifetime transfers at the time they are made. This can occur where assets are transferred into special arrangements, such as trusts.

There is no tax charge on exempt transfers (see page 5, 'Exempt transfers'), such as most gifts or bequests between husband and wife.

## The cumulation principle

IHT is a cumulative tax.

- All chargeable transfers are added up and tax is payable once the cumulative total exceeds the nil-rate band.
- A transfer 'drops out' of the cumulative total once it is more than seven years old.
- It therefore is not taken into account in calculating IHT on transfers more than seven years later.
- However, the transfer can still be relevant for a potentially exempt transfer made within seven years of the original transfer, where the potentially exempt transfer becomes chargeable on the transferor's death (see page 3, 'Potentially exempt transfers (PETs)').
- When death occurs, the value of the estate is added to the total of chargeable lifetime transfers in the previous seven years in order to calculate the tax due.

## Valuation of property

Assets are valued at their open market value for IHT purposes. There is sometimes a difference between the value of an asset to the donor and its worth to the donee. For IHT, the value is based on the loss to the donor's estate rather than the gain to the donee.

- For example, a 51% shareholder in a family company who transfers 2% of the shares will lose control of the company. This could generate a large reduction in the value of their shareholding, even though the 2% of shares received are not particularly valuable to the donee.
- Where a husband and wife own 'related property', such as shares in the same company, their assets are valued together.
- For example, if a husband and wife each own 30% of a company, their shares will be valued as a majority holding.

## Who is taxable?

An individual's assets are potentially taxable wherever they are situated, if the individual is domiciled (see below), or treated as domiciled, in the UK.

- An overseas holiday home, for example, does not escape IHT simply because it is abroad, even though it might also be subject to foreign estate taxes.
- There is a system of double taxation reliefs that may lessen the impact of two separate tax systems on an estate.

A non-UK domiciled person is liable to IHT only on assets situated in the UK. In many cases, the place where an asset is situated is self-evident, but there are special rules to determine the location of certain assets, such as shares or debts.

## **Domicile**

Basically, an individual's domicile is where they have, or are deemed to have, their permanent home.

- Determining domicile can be complex where people migrate.
- An individual who has been resident in the UK for 17 out of the previous 20 tax years is treated as domiciled in the UK for IHT purposes.
- Although emigration offers a possible method of completely side-stepping the tax after a period of time, it is not an easy option because it is necessary to sever virtually all ties with the UK. Once an individual has become domiciled outside the UK, a delay of a further three tax years is needed before the individual escapes IHT.

If there are any doubts about domicile status, one should always take expert advice: it could have important tax implications beyond IHT.

## **Potentially exempt transfers (PETs)**

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Some transfers, of any value, can be made without any IHT liability, as long as the donor survives the following seven years. These are known as 'potentially exempt transfers' (PETs). Once the donor has survived for seven years, they become wholly exempt.

PETs can be made by any individual to:

- Another individual (including transfers to a bare trust – see below).
- A trust for a mentally or physically disabled person.

### **Bare trusts**

A bare trust exists where the trustees act as nominees for the beneficiary (or beneficiaries) who is absolutely entitled to the assets, or would be if aged at least 18. For most purposes, this is not a true trust and beneficiaries are taxed as if they owned the assets absolutely. A gift to a bare trust is a PET because it is in effect a gift to an individual.

### **Interest in possession trusts**

Broadly speaking, an interest in possession trust is one in which the beneficiary has a right to the income from the trust or enjoyment of the trust property during their lifetime. On the beneficiary's death, or some other event specified in the trust document, the right to income, or outright ownership of the capital, normally passes to another beneficiary. The IHT treatment of interest in possession trusts changed on 22 March 2006. The old rules apply to interests created before that date and interests that come into being from 22 March 2006 that satisfy certain conditions (see below). New rules apply to all other interests that come into being from 22 March 2006.

- For IHT purposes, a beneficiary with the right to income from a trust to which the old rules apply is treated as the owner of the trust capital. It forms part of their taxable estate, and the trust capital is added to their estate to calculate IHT liability on death.
- Lifetime gifts into such trusts before 22 March 2006 were PETs.

- The transfer of the right to income from one beneficiary to another before 22 March 2006 was also a PET unless it occurred at death.
- From 22 March 2006, transfers of the right to income of an 'old rules' trust are chargeable, though no tax will be payable if the transfer is within the transferor's nil-rate band. However, there is a transitional relief for changes of interest in possession:
  - To pre-22 March 2006 trusts which occurred before 6 October 2008, and
  - Which arise on the death of a spouse or civil partner.

The basic interest in possession trust has many variants. The most popular type used to be the flexible trust, which allowed the trustees or settlor to vary the interests of the beneficiaries at any time in the future. However, since 22 March 2006 these trusts are treated in the same way as discretionary trusts for IHT purposes, making the more flexible discretionary trust the preferred option.

### **Death within seven years of a PET**

No tax is payable on a PET when the gift is made, and such gifts do not have to be reported to HM Revenue and Customs (HMRC) at the time they are made. If the donor dies within the seven years after the gift, the transfer could be subject to IHT.

Personal representatives are legally obliged to report gifts made by the deceased in the seven years before death.

The person who receives the gift is liable to pay any tax due, but the personal representatives become liable on any tax still outstanding one year after the death.

### **Tax on the PET**

The tax calculation is based on:

- The value of the gift at the time it was made.
- The cumulative total of chargeable transfers made in the seven years before the gift.
- The nil-rate band and tax rate in force **at the date of death**.

PETs will generally only become chargeable to IHT where total gifts made in the seven years before death exceed the nil-rate band. Thus very few PETs ever attract an IHT liability, although many reduce the available nil-rate band for the estate.

### **Taper relief**

Where the PET took place between three and seven years before the death and gives rise to a liability on death, the tax rate (not the value of the transfer) is tapered. Tapering means that the tax is reduced depending on the time between the gift and the date of death:

<b>Years between transfer and death</b>	<b>% of full tax rate payable</b>
Not more than 3	100
More than 3 but not more than 4	80
More than 4 but not more than 5	60
More than 5 but not more than 6	40
More than 6 but not more than 7	20

## Tax on the estate

When an individual dies, the value of any PETs in the previous seven years is added to the value of the estate. This could affect the amount of tax charged on other assets, because they are then treated as forming the top part of the estate. It may be worth covering the possible additional IHT on the estate by a term assurance policy, written on the life of the donor, for the seven years after the gift.

## Exempt transfers

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Some types of transfer are always exempt from IHT. Used systematically, these exemptions can play an important role in IHT planning.

### Transfers between husband and wife and between civil partners

Husbands and wives are taxed separately for IHT, as are partners in a registered civil partnership. If both spouses or civil partners are domiciled in the UK, transfers between them are exempt both during lifetime and at death.

- This exemption is not available to people living together who are not married or in a registered civil partnership, even where one is wholly dependent on the other.
- Where the recipient of the transfer is non-UK domiciled, the exemption is limited to £55,000.
- The exemption also applies to a life interest for a spouse or civil partner created by a will or under the intestacy rules.
- If the only transfers made by a spouse or partner during lifetime and on death are to the other spouse/partner, the first spouse's nil-rate band will remain unused on death and is available for transfer to a surviving spouse who dies on or after 9 October 2007, as explained above.

### The annual exemption

Any individual may give away up to £3,000 in each tax year free of tax. If the exemption is not used up in one year, it can be carried forward, but for one year only, and used in the following year after that year's exemption has been used in full. For example, a married couple or civil partnership who made no gifts in 2009/10 may together give up to £12,000 free of tax in 2010/11.

### Small gifts exemption

Individuals can make as many outright tax-free gifts as they like each tax year up to a total of £250 per donee per year. This exemption cannot be used to relieve gifts of over £250.

### Normal expenditure from income

Regular gifts from income are exempt from IHT if they do not reduce the usual standard of living and capital is not used.

- Regular premiums under life policies written in trust frequently fall within this exemption.
- With care, the exemption can be used to pass wealth to individuals, such as children, over several years. The gifts do not have to be of a fixed amount to qualify as normal expenditure. They could, for example, consist of the excess of the donor's income over a set amount and fluctuate in line with the donor's income.

## Wedding/civil partnership gifts

Individuals can make wedding gifts free of tax to either the bride or the groom or either party in a registered civil partnership. The value of the exemption depends on the donor's relationship to the couple:

- £5,000 if the donor is a parent of a party to the marriage.
- £2,500 if the donor is a grandparent or remoter ancestor.
- £2,500 if the donor is the bride or groom and the gift is made to the other prospective spouse before the marriage (after the wedding, gifts are covered by the spouse exemption).
- £1,000 if the donor is any other person.

Generally, to be sure of escaping a potential tax charge, the gift should be made at the time of, or shortly before, the wedding.

## Family maintenance

Lifetime gifts made for the maintenance of a spouse, child or dependent relative are generally exempt from tax. The exemption extends to stepchildren and adopted and illegitimate children.

## Charities, political parties and gifts for the national benefit

Gifts of any amount to registered charities and the major political parties are exempt from tax, whether made during lifetime or at death. Similarly, gifts to museums, libraries, universities and the National Trust are exempt. Gifts of land to housing associations are also exempt.

## Death on active service

The estates of members of the armed forces are completely free of tax on death if they die because of wounds received or diseases contracted on active service.

This exemption also applies to members of the Royal Ulster Constabulary who die from injuries caused in Northern Ireland by terrorist activity.

## Other lifetime transfers

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Lifetime transfers that are not exempt and are not PETs may be chargeable. The most common chargeable lifetime transfers are gifts into most types of trust.

### Calculating the tax

If the value of the transfer (plus any taxable transfers in the previous seven years) is more than the nil-rate band, the excess is liable to IHT at 20%.

- Tax is charged on a cumulative basis, taking account of all taxable gifts, but not exempt transfers, within the seven years before the transfer. Therefore it is possible to give away the nil-rate band (£325,000 for 2010/11) every seven years by means of chargeable transfers without incurring any tax liability on these gifts.
- Unless the recipient of the gift pays the tax due, the donor is treated as making the gift net of tax and in consequence tax is charged on its grossed up value. For example, if a donor settles £500,000 on a discretionary trust and pays the tax, the excess £175,000 over the nil-rate band is the net gift and the IHT is £43,750 – 20% of the gross gift of £218,750 (£175,000 x 100/80).
- If the donor dies within seven years, there may be more tax to pay. The tax is calculated in the same way as for a PET (see page 4, 'Death within seven years of a PET'), but the

tax already paid is allowed as a credit. Generally, this means there is no further tax liability after five years because the effective IHT rate on death after taper relief is less than 20%. If a donor dies after more than five years, it is not possible to reclaim any of the earlier tax paid on the chargeable lifetime transfer.

## **Discretionary trusts**

A discretionary trust is the most flexible form of trust. Income may be distributed at the discretion of the trustees or, for a limited number of years, accumulated within the trust. The trustees also have discretion to decide the shares of capital, if any, that each potential beneficiary eventually receives.

- The transfer into a discretionary trust is taxable, if it plus accumulated earlier transfers is greater than the nil-rate band.
- There is also a periodic tax charge on the trust every ten years. Broadly speaking, this is based on the trust's value and the individual settlor's seven-year cumulative gifts total at the time the trust was set up. The maximum rate of tax is 30% of the normal lifetime tax rate, ie  $30\% \times 20\% = 6\%$ .
- There may also be an exit charge on the trust when a distribution of capital is made from the trust. This is a proportionate charge to tax, based on the tax rate levied at the previous ten-year anniversary. If an exit charge occurs within the first ten years, the rate is calculated by reference to the value of the trust property when settled.

## **Accumulation and maintenance trusts**

An accumulation and maintenance (A&M) trust is a form of discretionary trust with a structure defined by the Inheritance Tax Act 1984. Until 21 March 2006 there were no ten-year charges and exit charges on an A&M trust that:

- Has beneficiaries who are all grandchildren of a common grandparent and are aged under 25; and
- Ensures that the beneficiaries become entitled either to the trust capital, or at least to the income of the trust, by the age of 25 at the latest. The capital may pass at a later date; and
- Accumulates any income that is not applied for the education, maintenance or benefit of the beneficiaries.

A&M trusts created before 22 March 2006 remained free of IHT up to 5 April 2008. They now come under new rules for A&M trusts, provided the beneficiary will take the trust assets absolutely by the age of 25.

- There are still no ten-year charges.
- There is no exit charge where the beneficiary becomes fully entitled to the trust's property on their 18th birthday.
- The entitlement can alternatively be deferred to any age up to 25, but this would give rise to an exit charge.
  - The charge is 0.15% for every full three-month period by which the beneficiary is over 18.
  - This means that the maximum charge, which arises when the beneficiary is 25, is 4.2%.
  - The nil-rate band is available, after deducting any chargeable transfers that the settlor made in the seven years before setting up the trust. In most cases, therefore, if the value of trust property is not more than £325,000, there will be no IHT to pay.

Trusts set up after 21 March 2006 using the old A&M conditions are treated as discretionary trusts (with ten-year and full exit charges) unless:

- They come into being under the will or intestacy of a deceased parent, or
- They are established under the Criminal Injuries Compensation Scheme.

Such trusts must satisfy the requirement for the beneficiary to take the property absolutely by age 25. New trusts that satisfy these conditions are subject to the lower exit charges described above.

## Transfers on death

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For most people, death is the only time when an IHT liability is likely to arise, and then only if the estate plus chargeable lifetime gifts exceeds the nil-rate band. At death, the value of the estate, together with the value of all lifetime gifts, but not exempt gifts, made in the preceding seven years, is calculated and the appropriate amount of tax is charged.

Some small payments received as compensation for wartime persecution by the Nazis are excluded from the estate, as are compensation payments for dormant accounts received by Holocaust victims or their heirs from banks and building societies.

Although winding up an estate can take a long time, IHT is payable six months after death. As a result, it is often necessary to make payments to HMRC on account to avoid building up interest charges. The personal representatives might have to borrow the money, because it might not be possible to realise cash from the estate quickly enough. Alternatively, a voluntary scheme agreed between the British Bankers' Association, the Building Societies' Association and the government enables personal representatives to pay IHT by electronic transfer out of the balance in the deceased's accounts at participating institutions. A similar scheme operates for investments with National Savings and Investments.

Tax on some assets can be paid in instalments over ten years. These assets include:

- Land and buildings.
- A controlling shareholding in a company.
- Some shareholdings in unquoted companies.
- An interest in an unincorporated business.

For shares and securities giving control, and for land and buildings included in a business or partnership, interest is payable on instalments only when the instalments are not paid on time. For other assets, interest is charged on the full amount outstanding at the rate in force at the time.

## Reliefs for business assets

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Interests in businesses and agricultural property may benefit from some extremely valuable reliefs. The reliefs reduce the taxable value of the transfer by 100% or 50%. There is also a deferment relief for woodlands.

## **Business property relief (BPR)**

The following may qualify for 100% relief:

- The business of a sole trader or an interest in a partnership.
- Shareholdings in an unlisted trading company, including shares in companies listed on the Alternative Investment Market (AIM) and OFEX (Plus Markets now operates what was the OFEX market).

The following may qualify for 50% relief:

- Shares or securities giving control of a quoted trading company.
- Land and buildings, or machinery and plant, owned by the individual and used wholly or mainly by a trading company under their control, or by a partnership in which they are a partner.

A transfer must satisfy several important conditions to qualify for BPR:

- The individual must have owned the property for at least two years before the date of the transfer. This rule can be relaxed where the asset was acquired on a death, in particular on the death of a husband or wife. There are special rules for replacement property.
- The relief does not apply to businesses that consist wholly or mainly of dealing in securities, stocks or shares, land or buildings, or making or holding investments.
- Relief for a trade, or trading company shares, can be restricted if any of the business assets have not been used mainly for allowable business purposes, or are not necessary for future business use.
- There must be no binding agreement for sale of the interest in the business.
- Some gifts made within seven years of death can become chargeable on death if certain conditions are not satisfied. Basically, the assets received as a PET must still be owned by the original recipient, and they must qualify as business property at the date of death. The relief may still be available if the assets have been replaced with other qualifying assets.

## **Agricultural property relief (APR)**

APR is given only on the agricultural value of farmland, together with farm buildings. The definition of 'agriculture' for this purpose is quite broad, eg it includes forestry, fish farms, stud farms and intensive livestock rearing.

- The 100% relief is available where the donor has owned and farmed the land for at least two years before the transfer, or where the donor can obtain vacant possession within 24 months.
- The 100% relief is also available where the land is farmed by a tenant under a lease that started after 31 August 1995, and the owner cannot obtain vacant possession within a year. The donor must have owned the land for seven years and it must have been farmed throughout that period.
- The 50% relief is given where the land is farmed by a tenant, as above, but under a lease that started before 1 September 1995.
- Not all the assets of the farm will qualify as agricultural property. In particular, part of the value of the farmhouse is frequently disallowed, and in some cases may not be allowed at all. Outlying 'amenity' woodland might also be disallowed.

- An individual is treated as occupying the land if the land is farmed by a partnership of which they are a partner, or a company that the individual controls. A gift of shares by a controlling shareholder in a company owning agricultural land may therefore qualify for APR.
- Where APR and BPR are both available, APR is given first. A farm with property development value will qualify for APR on its agricultural value and BPR may be given on the enhanced value. Generally, assets in a farming business will qualify for BPR, even if they do not qualify for APR.
- If the donor dies within seven years of making a gift that qualified for APR there may be a tax liability, eg if the land is not still owned by the recipient or no longer qualifies as agricultural land.

## Woodlands relief

IHT on growing timber in the UK (but not the land) can be deferred until disposal of the timber. However, if the deceased occupied the woodlands for commercial purposes, 100% BPR may be available, which is preferable to deferral.

## 2009 Finance Act

Both IHT APR and woodlands relief were extended to property in the European Economic Area (EEA). The change affects IHT due or paid after 22 April 2003 for agricultural property in an EEA state. The earliest deadline for reclaiming overpayments of IHT will be 21 April 2010.

## Gifts with reservation

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There is a special rule that prevents people from obtaining any IHT advantage by giving away assets and continuing to benefit from them, eg a parent who gives away a house to children but continues to live in it rent-free. Such transfers are called 'gifts with reservation' and are still counted as being in the donor's estate at death for the purpose of calculating IHT. To be effective for IHT, any property transferred must be enjoyed to the entire, or virtually entire, exclusion of the donor during the seven years before their death. If a person's interest in a trust is terminated, but they are not removed as a potential beneficiary of the trust, this will be treated as a gift with reservation.

## Chargeable transfers

A gift with reservation may give rise to an immediate tax charge, but it is still treated as remaining in the donor's estate until the reservation is released, ie the donor's enjoyment ends. If the donor dies before the release, there are rules to prevent a double charge to tax.

## PETs

If at some future date the donor renounces their interest in the gift, they will be making a gift of the value of the asset at that time. This is treated as a PET; so if the donor survives for a further seven years the gift will become completely exempt.

## Exceptions

There are some exceptions to the gift with reservation rules. Transfers are not gifts with reservation if:

- A full market rent is paid for the enjoyment of land or chattels, or
- The gifted property is occupied by the donor because:

- There has been an unforeseen change in the donor's circumstances, and
- The donor is no longer able to maintain him or herself through old age, infirmity or otherwise, and
- Occupying the property is a reasonable provision by the donee for the care and maintenance of the donor, and
- The donee is a relative of the donor or donor's spouse.

## **Income tax on 'pre-owned assets'**

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Various, largely contrived, arrangements have been devised that avoid the gift with reservation rules but still allow the donor effectively to enjoy a benefit from an asset given away. Typically such schemes have involved placing the family home in a trust.

### **The income tax charge**

From 6 April 2005, income tax is charged on the benefit people get by having free or low-cost enjoyment or use of certain assets they formerly owned, or provided the funds to purchase.

- In the case of land, the amount of benefit on which tax is charged is based on market rentals.
- For chattels and intangible assets, the cash value of the benefit is normally a percentage of the open market value, the percentage being equal to the official interest rate for income tax purposes. This is 4.00% from 6 April 2010 (previously 4.75%).
- The valuation date for property subject to the charge is 6 April in the relevant tax year, or the date it becomes subject to the charge if that is later.
- Where the property is land or chattels, it need be revalued only every five years. For example, an asset that was held before 6 April 2005, and became liable to income tax on the introduction of the pre-owned assets tax, will be revalued at 6 April 2010.
- No tax is charged in any year in which the cash value of benefits is £5,000 or less, implying a market value for chattels and intangible assets of no more than £105,263 in 2008/09 (£125,000 from 6 April 2010).
- If a person pays for the benefit obtained from the asset, the amount paid is deducted from the taxable cash value.
- Disposals of assets any time from 18 March 1986 onwards (the date of the introduction of IHT) give rise to income tax if the former owner enjoys a benefit under these rules.
- The rules catch some business life insurance trusts, set up to ensure that a partnership or private company can continue after the death of one of the partners or shareholders while enabling the estate of the deceased to receive the value of the interest in the business. However, in many cases the value of the benefit will not exceed £5,000, so no tax will be chargeable.

### **Exclusions and exemptions**

There are certain exclusions and exemptions from the income tax charge. They are:

- Assets transferred to a spouse or civil partner.
- Assets sold at an arm's length price paid in cash.

- The asset still counts as part of the donor's estate under the gifts with reservation rules.
- Any enjoyment of the asset is no more than incidental. This includes cases where an outright gift to a family member comes to benefit the donor following a change in their circumstances, such as ill-health or disability. In general, former owners are not regarded as enjoying a taxable benefit if they retain an interest that is consistent with their ongoing enjoyment of the property. For example, there is no income tax where an individual who formerly owned the whole of their home passes a 50% interest to someone, such as a child or partner, who lives with them.
- Commercial equity release schemes are exempt from the tax, even where the owner has not disposed of the whole of the property. This exemption is extended to disposals of a part interest in property to family members, subject to certain conditions. These are that the transaction was on arm's length terms and either occurred before 7 March 2005 or is made later but for consideration other than money or readily realisable assets.

## Opting out

Taxpayers involved in existing schemes may be able to avoid income tax by undoing the arrangements. However, this may not be possible with some trust-based plans, especially where any of the beneficiaries of a trust are minors.

Another way of avoiding the tax is by electing for the asset to be subject to IHT on death.

- This is done by completing HMRC form IHT 500.
- In principle, the election must be made by 31 January following the end of the first tax year in which income tax arises. For 2005/06, which is the first year in most cases, the election therefore had to be made by 31 January 2007. However, HMRC can accept an election after the normal deadline.
- If an election is made, the property in question is treated as part of the former owner's taxable estate for IHT purposes, while they continue to enjoy it, in essentially the same way as under the 'gift with reservation' rules.
- Regulations prevent a double charge to IHT on a death within seven years of the original gift. Without special rules, IHT would have been payable twice: on the original PET becoming chargeable as a result of the death, and again on the asset that is the subject of the election.

There are several factors to consider in deciding whether to opt out of the pre-owned assets tax. In some cases, it may be preferable to suffer some income tax in order to achieve a significant IHT saving.

## Tax planning key points

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It should be noted that changes may be made to the legislation and planning must be reviewed regularly as circumstances change. The key points to note are:

- The simplest planning is often the most effective and, as regards IHT, action taken earlier is generally preferable to that taken later.
- Lifetime gifts out of income and the various the statutory exemptions can aggregate to considerable sums.

- The detailed conditions for the various reliefs (eg BPR) need to be noted to ensure that relief is not inadvertently lost.
- The gift with a reservation rule may be a particular issue where the taxpayer wishes to continue to enjoy the benefit of 'ownership'.

*This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at May 2010, which are subject to change.*