

Your guide to inheritance tax

IHT is essentially a form of death duties - the tax charged on what you leave behind when you die.

In some ways it's a fee charged by the government for allowing you to leave at least some of your wealth to your heirs. Leaving aside questions over the appropriateness of this, the fact remains that it is there to tax at 40% the value of all the assets you leave behind on death apart from the first £275,000-worth (lifted from £263,000 in the March 2005 budget).

In practical terms, IHT has to be paid by someone's executors before they are able to manage their assets and potentially hand them on to the beneficiaries.

Calculating IHT

The basic calculation of IHT is simple - value all the assets that are left behind on death, add them up, knock off £275,000 (the "nil rate band") and tax what's left at 40%.

There are some extra points to this calculation.

For a start, if the deceased gave away assets within the seven years before death, those assets have to be counted into the value of the estate though any tax due may be reduced from the 40% level.

There are also a number of exemptions which mean the property or amount in question can be left out of the calculation.

The most important of these is property left to a UK-domiciled spouse. Other exemptions include charitable gifts and bequests.

Basic IHT planning

Many will have spotted that you can avoid IHT entirely by leaving all your property to your spouse. However, this could increase your IHT bill in the long run.

To take a simple example, suppose that both husband and wife each have assets of £250,000. If on husband's death his share is left entirely to wife, there will be no IHT. But when wife dies there will be IHT on £500,000 less £275,000 = £225,000 @ 40% = £90,000.

If husband had left the £250,000 direct to the children there would be no IHT then or indeed on the wife's death because both nil rate bands would have been used. This is an example of how important it is to use the nil rate band - though practicalities must always be borne in mind.

There are things that can be done throughout life. There are little exemptions such as an annual exemption of £3,000, exemptions for certain marriage gifts and a useful one known as normal expenditure out of income. In other words, what the taxman is keeping an eye open for is simply gifts out of capital.

It is also possible to think in terms of giving sums away, surviving seven years and thus getting that gift out of your IHT "reach". Reliefs available for agricultural and business property can also be planned into your thinking.

One factor that should certainly be in your planning is to make sure you have a proper will. Of itself it won't save IHT, but will at least make sure your assets go where they are intended to and that any IHT planning you have done is effective.

What about the family home?

The increase in value of properties is why many more people are being drawn into the IHT net. The value of an average house in London and the South East almost automatically gets you into IHT and other areas of the country are not far behind.

It is not easy to give the family home away. Ideas such as giving it away to the children and continuing to live there don't work for IHT planning unless you go to the extreme of paying your children a (taxable) full market rent.

But you can at least look at how you hold the property - for example if a married couple hold the house as tenants in common it means they each own half the property and can pass that half on as they wish rather than the usual situation where holding the property as joint tenants means that the survivor takes all.

IHT is a tax that can be planned for, at least in terms of its impact. You may not be able to take your wealth with you when you go but you can at least make sure the taxman doesn't get a greater share than he has to!