



Reduced Rate of IHT on Gifts to Charity

From 6th April 2012, the government is introducing new Inheritance Tax legislation in the form of the Finance Bill 2012 that could affect anyone planning to pass a proportion of their estate to charity. Gifts to charity are already exempt from IHT but the new rules mean that the rate of IHT on the rest of the estate can be reduced from 40 per cent to 36 per cent. So, although charitable beneficiaries would receive the same amount, non-charitable heirs will be better off under the new measures.

However, the new rules are complex and careful advice should be given as to how they will apply in each client's circumstances.

On death, an estate will be divided into different components for tax purposes, each of which needs to be looked at separately. These are: property held jointly as joint tenants, property held in a trust that is treated as part of the estate for IHT purposes and a general component which is essentially everything else. Within each of these components, any reliefs or exemptions such as the available proportion of the nil-rate band will be deducted firstly to ascertain the chargeable element. The charitable gift is then added back to reach the 'baseline amount'. If more than 10 per cent of the amount (after exemptions) within one component passes to charity then the reduced rate of 36 per cent will apply to the rest of the assets within that section.

Let's assume the survivor of a married couple dies after 5th April 2012 leaving an estate of £1m and their Will includes a bequest of £50,000 to charity and passes the rest of the estate to their children.

After the combined nil-rate bands of £650,000 are taken into consideration, the 'baseline amount' here would be £350,000. This means that the £50,000 charitable gift comes to more than 10 per cent of the baseline amount so the reduced 36

per cent rate of IHT will apply to the bequest to the children.

As a result, the IHT liability is reduced to £108,000 instead of £120,000. The charity receives £50,000 and the children receive £842,000 which is £12,000 more than they would have received under the current rules. Even though the amount passing to charity is less than 10 per cent of the overall estate, the reduced rate applies because it is more than 10 per cent of the 'baseline amount'.

An added complication is that even a charitable gift under the survivor's Will of say £25,000 (which is less than 10 per cent of the "baseline amount" of £350,000 for the estate) could trigger the reduced rate of IHT if the estate consisted of more than one component.

For example: rather than passing outright, if the assets of the first to die were held in trust for the surviving spouse (a common scenario to offer asset protection) the estate would be split into two components. This means each component would be £500,000 and the 'baseline amount' for the general component would be £175,000. As £25,000 is more than 10 per cent of £175,000, the reduced rate would apply to the rest of the assets passing under the survivor's Will.

It should be noted that residuary beneficiaries will always receive less as a result of charitable legacies (compared to what they would have inherited if there was no philanthropy) both under the present and the proposed systems, but the reduction in the rate of inheritance tax will no doubt encourage more charitable giving which is part of the Government's background policy.

We hope you find this useful, but please do not hesitate to contact us for further information.

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