Inheritance Tax (IHT) – Double Taxation or Misunderstood?

In 1789, Benjamin Franklin wrote "In this world nothing can be said to be certain, except death and taxes." Unfortunately, it seems that in the modern society, death doesn't preclude your duties to Her Majesty's Government, or indeed other governments the world over.

In the UK, each person can (currently) leave an estate of up to £325,000 untaxed to children. Assets left to a spouse have always been untaxed. By 2010, this will raise to £350k per person. Those who are married can pass their allowance onto their surviving partner to then use on the entire estate.

Except that means that marriage has to last, in this divorce culture, the idea of a sure thing marriage that will actually be 'until death do thee part' is a romantic notion.

Even in the midst of recession, house prices in my area are still sky high. A terraced house sells for over £330k. That on it's own is over the 2009 inheritance tax threshold. If you own a house, you'll probably end up paying the IHT. On the bright side though, a house is usually the most expensive asset you'll have. It's a great one as well; it's one that you'll normally pay for over the course of your life.

Assuming a 90% Mortgage over 30 years paid back at 7% interest (it's a bit high, but it will serve well for the point I'm making) you'd be paying over £2000 a month. Now think for a moment, how much would you have to make to be able to afford such a regular outlay of so much? Think about it? That's £24k a year. How much does it cost to live? £120 a month for groceries, say, £2k per year for good measure, (more once a family comes along) then you've got utility bills and such to pay, incidentals, insurance, it all adds up, as a total for living expenses, would £10k be a good number? Roughly £35k per year would be needed to live in a terraced house.

To pocket £35k per year, what would you need to actually earn? Roughly £42,000, on such a salary, you'd be paying £7,105 a year in tax. Over the course of the mortgage, you'd be paying over £210,000 in Income Tax alone.

We must remember of course, that not many people stumble into a £42k per year job straight out of university, it will normally take years of hard work, of paying disproportionate amounts of rent for a small room in a large house full of people just like you. Debts run up quickly and take years to get rid of.

Of course these are all just rough numbers but it does give an idea of how much actually gets into the governments pockets from what you're earning, is it right that once you die HMRC gets another 40% of your estate if it's worth more than the threshold. Well luckily it doesn't actually work that way.

With the current Threshold at £325,000 if your total assets total at £326,000 you will not end up paying tax on £326,000, it is only what is above the nil-rate band that is taxed, i.e. you'd pay the tax on the £1000 over the allowance, at a total of £400. It's still a lot, but it's a lot better than the £130,000 that you'd pay on the full amount.

It should still be worrying that a house on it's own can take you over the limit.

Those who marry and stay as such end up being better off. Their allowances combined allows for £750,000 to be left without charge, to compare this with a single person, the two would be able to afford to buy a larger, detached house and upon their deaths it would leave plenty of the allowance available for the other assets.

The wealthier members of society are however, much worse off, even the married wealthy. It's not uncommon now for people to own holiday homes, it doesn't take much to do such a thing. Taking out a mortgage, either on the main home or indeed on the holiday home could raise funds to cover most of the costs associated with it. Then you get an additional income should you decide to rent it out whilst unoccupied.

Houses are of course not the only possessions that are subjected to the Inheritance tax, most of what you own is. In fact, it's not even what you own, it's what you've owned in the past 7 years. Gifts that you've given up to 7 years prior to your death may sometimes be included. Money from bank accounts and savings accounts are taken into consideration, cars and other items of your personal property are counted up. It becomes very obvious, very quickly, that the inheritance tax is very easy to have to pay.

Yet official figures have shown that in 2007, 94% of all estates were classified as exempt from payment. It's too easy to get around, that is the final line in the matter, there are loopholes, there are marriages of convenience and there are hundreds of websites offering advise to avoid paying. Is it any wonder that it accounts for less than 1% of the government's annual income when it seems at a glance to be easy to get around?

Like so many other things, planning is what it all comes down to. If you have the forethought to go through everything it's relatively easy to get things lined up years in advance. Of course the problems here are plentiful as well. A retired person could easily sign everything over to their children on the day of the retirement and then go on to live for another twenty years.

Remember no matter how much you leave behind, any inheritance tax payments are going to be taken out of your estate before it's passed onto those named on your last will and testament.

However, that is not necessarily a good thing. The chances are good that your house and personal effects may have to be sold, especially if you don't have the free cash to cover the cost of the tax payment.

It is however amusing to investigate things that are not required to be counted in the totaling of your estate, even going back the seven years, you can leave anything you want to a registered charity, it's not chargeable, you can give £3000 a year in gifts. There is a value of up to £5000 you can give away as a wedding gift. This amount however varies depending on how you're related to the happy couple. Political Donations are sometimes free of charge.

So now to the question on everybody's minds. How do I reduce the amount that your inheritors will be paying? Well there are two main ways of going about it. You can either reduce the value of the estate or you could line up a way of paying for it yourself. It's peculiar to think about, paying off the cost of leaving your estate to someone (or to several people) but it's fairly simple to work out. Financial advisors would be the best people to ask about such things, as it is their job to know the best way of getting through the system.