CashCalc Specification Sheets (Client Facing)

Inheritance Tax (IHT) Calculator

Overview

The Inheritance Tax (IHT) Calculator is used to show the client their potential tax liability that may occur on death. This calculator includes multiple forms of planning to attempt to reduce any IHT liability that the client may encounter.

Assumptions

Below is a list of all assumptions made to perform the calculation:

- Figures are rounded up to the nearest penny
- Inflation has a range between 0.00% and 10.00% (Default: 2.00%)
- Net Growth Rate has a range between 0.00% and 10.00% (Default: 2.00%)
- Consumer Price Index has a range between 0.00% and 10.00% (Default: 2.00%)
- Growth is calculated annually at the end of the year
- Any liabilities must be secured to an asset and paid on death of the owner
- Each year in the calculations refers to the tax year starting in that year, for example year 2018 is the tax year 2018/19

Calculations Breakdown

IHT is the tax that you pay on money or possessions you leave behind when you die. There are many ways to avoid IHT which this calculator attempts to simulate to give the client an idea of any potential IHT their heirs may encounter. Money or possessions are taxed at 40% of anything over the clients' Nil Rate Band (NRB) of £325,000 (correct as of 2017, this value is frozen until 2019).

This calculator estimates growth based on the assumed rate of inflation and assumed growth (net of charges and fees) from the current date and the assumed age at death. This is calculated with the following formula:

$$\text{Asset Value}_N = (\text{Asset Value} \times (\text{Growth} - \text{Inflation}))^{(\text{Age at death} - \text{Client's age})}$$

Nil Rate Band

Every person has their basic Nil Rate Band (NRB) of £325,000, this value has been frozen until 2019. If your client has a previously deceased spouse, any NRB they did not use can be transferred to your client to be used when they die. This is done on a percentage basis. For example, if your client's previous spouse used £100,000 of their £325,000 NRB on death, they would have $((225000 / 325000) \times 100)$ = 69.23% of their Nil Rate Band available for transfer. This percentage is of the NRB of the year in which death occurs.

A client can transfer multiple previously deceased spouse's NRB to be used on their death, but this value can only equate to 100% of the current band. For example, a client had two previous spouses, each with 60% of their NRB remaining. This does not mean that the client can use and extra 120% of their current NRB, but 100% as it has been capped.

Residential Nil Rate Band

As of the 2017/18 tax year the government has introduced the Residential Nil Rate Band (RNRB) which grants each person an additional £100,000 towards passing their main residence on to their children (including adopted, foster or stepchildren - or their grandchildren). This band will increase to £175,000 by 2020 and from then onwards increase alongside CPI. A table of these figures can be found below:

Tax year	Value of RNRB
2017/18	£100,000
2018/19	£125,000
2019/20	£150,000
2020/21	£175,000
2021 tax year onwards	£175,000 x CPI^{Year}

The RNRB begins to taper once the clients' net estate has breached the £2,000,000 (also increases with CPI after 2021) threshold in the same manner that your clients' personal allowance does. This taper is calculated by reducing the current band by £1 for every £2 the client's net estate is over the threshold.

If the client has a previously deceased spouse, if they did not use their RNRB it can be transferred to the surviving client to be used on death. This includes any previous spouses that died before the 2017/18 tax year. Transferring RNRB rules are the same as those for transferring NRB.

This calculator will attempt to use the maximum RNRB it can by utilising the clients' NRB on other assets before the main residence.

Repayable loans

If the client has a repayable mortgage/loan outstanding, this can be modelled in the Inheritance Tax Calculator. The calculations for the repayments and value at year's end can be found in the *Mortgage Calculator* specification sheet.

Potentially Exempt Transfers

A Potentially Exempt Transfer (PET) is a gift between individuals, or a gift to an absolute trust or a trust for a disabled beneficiary. A PET can be greater than the available NRB at the time and no IHT will be payable at the time the gift is made. If the donor survives the gift by seven years, the gift will fall outside of the client's estate for IHT purposes and will utilise the first part of any available NRB. If the client did not survive the gift by 7 years, there is a tapering relief available for the PET on the amount of tax they will pay on it depending on how many years have passed since the gift. These figures can be found below:

Time since gift was made	Effective rate of tax
0-3 years	40%
3-4 years	32%
4-5 years	24%
5-6 years	16%
6-7 years	8%
7+ years	0%

NB. Using the above figures is the equivalent of giving 20% relief of the value taxed at 40% in year 3.

Chargeable Lifetime Transfers

A Chargeable Lifetime Transfer (CLT) is a gift into most types of trusts (not including an absolute trust or a trust for a disabled beneficiary). If this gift is in excess of the available NRB, IHT at the rate of 20% will be charged on the excess. If the client survives the gift by seven years, the gift will fall outside of the client's estate for IHT purposes. If the client does not survive the gift by seven years, the gift will be added back into their estate for IHT purposes in the same way as for PETs. We assume that any tax paid on a CLT in excess of the available NRB is made by the donor.

The 14-year rule

If a CLT has been made in the past 14 years, it may affect any PETs made within 7 years of the clients' death. When a CLT is made, it effectively reduces the available NRB the client has for the next 7 years. If a PET were to fail due to the client not surviving the gift by 7 years, the value liable to IHT will be calculated by subtracting the available NRB at the time the PET was made from the value of the PET.

IHT Planning

This tool has many methods of reducing any IHT liability that a client may have, below is a brief explanation of how each type of planning will affect the asset and the overall IHT position.

Legacy to Residual Estate

This is the default planning for most assets in this calculator. It effectively leaves a percentage of the estate to the surviving spouse and the remaining value will leave the estate on first death. On second death, the full value of the asset will leave the estate and be completely liable to IHT.

Example Calculation: The client wants to leave 40% of his £500,000 estate to his spouse, and pass the rest to his children.

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ON FIRST DEATH

To the spouse = 500,000 x 0.4 = £200,000
To the children = 500,000 x 0.6 = £300,000

ON SECOND DEATH

Value liable to IHT = £200,000
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Any value that is passed to the surviving spouse is assumed to be an Exempt Transfer and will accrue no IHT liability. The remaining value that leaves the estate will accrue an IHT liability.

Life Cover (Not to spouse)

This planning would write the life cover policy into trust so that it never enters the clients' estate for IHT purposes.

DC Pension (Not to spouse)

This planning would keep the DC pension in its wrapper and outside of the client's net estate for IHT purposes.

Death in Service (Not to spouse)

This planning would write the Death in Service bond to a trust so that it never enters the clients' estate for IHT purposes.

Expression of Wish

This planning would keep the asset outside of the estate for IHT purposes.

Leave in Pension Wrapper

This planning would keep the DC pension in its wrapper and outside of the client's net estate for IHT purposes.

Legacy to Trust

This planning will write this asset into a trust on death of the owner, if this occurs on first death then the asset will be outside of the estate on second death.

Invest into BPR (100% relief)

Investing into a Business Property Relief scheme will cause the amount invested to be exempt from IHT after 2 years from the date of investing. If the client does not survive the 2-year period before the IHT exemption, it can be passed to a surviving spouse and the current duration continues under the ownership of the surviving spouse.

Example Calculation: The client has invested £200,000 into a BPR and dies after 1 year

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ON FIRST DEATH – 1 year after investment

Potential Value Liable to IHT = 200,000
Value transferred to the spouse = 200,000
IHT Liability = 0

ON SECOND DEATH – 3 years after investment

Value Exempt from IHT = 200,000
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Agricultural Relief (50% or 100% relief)

The client can get a 50% or 100% relief on IHT if they were to invest their asset into an agricultural scheme after 2 years. If the client does not survive the 2-year period before the IHT exemption, it can be passed to a surviving spouse and the current duration continues under the ownership of the surviving spouse.

Example Calculation: The client has invested £100,000 into a 50% relief agricultural scheme and dies after 1 year

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ON FIRST DEATH – 1 year after investment

Potential Value Liable to IHT = 100,000
Value transferred to the spouse = 100,000
IHT Liability = 0

ON SECOND DEATH – 3 years after investment

Value Exempt from IHT = 50,000
IHT Liability = 50,000
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Potentially Exempt Transfer (PET)

This planning option will cause the asset to fall outside of the estate after 7 years from the year that it was made, if the client who made the gift survives beyond that date. If they do not, the rules stated in the previous section will apply.

Example Calculation: The client made a PET of £300,000 in 2015. Based on mortality rates, it is assumed that they may die in 2020. If this is the case, the PET will fail, and it will come back into the estate and use up the first £300,000 of the clients NRB will be used by the PET. As the PET was 5 years in, any amount of the PET that falls outside of the client's NRB will be taxed at 16% instead of 40%.

Use Annual Gift Allowance

This planning option will make an asset use the full £3,000 gift allowance per year for each client who owns the asset, so if both client's own this asset it will reduce by £6,000 per year ongoing.

Example Calculation: The clients both gift £3,000 a year to their children, in their current state of health they anticipate that they will both be doing this for the next 20 years.

$$\text{Value of asset}_{\text{At year Y}} = \text{Value of asset}_{\text{Now}} - (6000 \times Y)$$

Chargeable Lifetime Transfer (CLT)

This planning option will gift a sum of money into a trust to fall outside of the estate after 7 years. If the gift is greater than the current NRB, there will be IHT to pay at 20% on the excess. This calculator assumes that any tax owed on investment of a CLT is paid for by the client and not the trustees. As the donor pays for the IHT due, the net transfer value has to be grossed up to make up for the loss to the estate.

Example calculation: The client made a CLT of £350,000 in 2012 and decided to pay the tax due for this himself.

$$\text{Excess} = 350{,}000 - 325{,}000 = 25{,}000$$
$$\text{Grossed up value} = 25{,}000 \times 1.25 = 31{,}250$$
$$\text{IHT paid at } 20\% = 31{,}250 \times 20\% = £6{,}250$$

Assuming the client was to die in the 2017/18 tax year, the CLT would only be 6 years old and would be considered a failed transfer. Because of this, the beneficiaries of their estate would have to pay regular IHT for the asset being in his estate. This asset will completely use the £325,000 NRB with £25,000 excess. Due to the CLT being 6 years old, the effective rate of tax would be 16%. This means the IHT to be paid would be £25,000 x 16% = £4,000. The beneficiaries will receive a relief of the amount paid on investment (£6,250), which would completely cover the tax due and thus there would be no tax to pay on this asset on death. If the tax owed was greater than the tax paid, the beneficiaries would have to pay the difference.

Discounted Gift Trust (DGT)

This planning option will make a CLT under the same rules as above, however the value that is liable to IHT is discounted to the value provided. This discounted value liable to IHT will be taxed at the tapered rate for the age of the trust plan.

$$\text{IHT due} = \text{Discounted value} \times \text{Tapered Tax Rate}$$

Loan Trust

This planning option will simulate what happens when a lump sum of money is invested in a loan trust. The loan trust is considered a CLT when first invested, this may affect any future gifts. The loan trust will reduce its value by 5% every year until 20 years has passed since the initial investment, the calculator assumes this money is spent

Legacy to Spouse

This planning option will give the asset to the surviving spouse tax-free. This asset will then be liable to IHT on second death.

Legacy to Partner

This planning option will give the asset to the surviving partner, subject to IHT. This asset will also be liable to IHT on second death.

Legacy to Other

This planning option will cause the asset to leave the estate on death, this asset will be 100% liable to IHT.

Legacy to Direct Descendant

This planning option will cause the asset to leave the estate and use the RNRB. If both clients jointly own the asset, on first death it will transfer to the surviving client and on second death it will leave the estate and use both clients' RNRB.

Tenants in Common (Share not to spouse)

This planning will cause each share of the asset to leave the estate on the clients' death, this value will be liable to IHT.

Example: The clients own their £650,000 home in 50% shares in a tenants in common agreement. On first death, his 50% share of the house would leave the estate and have £325,000 liable to IHT. On second death, the remaining share would leave the estate and be liable to IHT

Tenants in Common (Share into trust)

This planning will cause each share of the asset to leave the estate into trust on the clients' death, this value will be liable to IHT.

Tenants in Common (Share to Direct Descendant)

This planning option will cause each share of the asset to leave the estate on the clients' death, this will be liable to IHT and will use the clients' RNRB when it leaves the estate on first and/or second death.

Gift to Charity

This planning option will immediate reduce the assets value by the amount specified. The reduced value will be the one used for any growth calculations that may occur. Unless you have assumed a client to die in the current year, they will not receive the tax reduction given to those giving money to charity in the same year as they die. This asset will then become liable to IHT on first and/or second death.

Legacy to Charity (On First Death)

This planning option will gift 100% of the asset to charity on first death, this could lead to gaining a reduction in tax. There is no IHT liability on this asset.

Legacy to Charity (On Second Death)

This planning option will gift 100% of the asset to charity on second death, this could lead to gaining a reduction in tax. There is no IHT liability on this asset.