

STARTING A PRIVATE PRACTICE

Be alive to inheritance tax threats

Liabilities for inheritance tax don't just kick in after you die. They can affect successful independent practitioners while they are very much alive. **Ian Tongue** (right) explains the tax and what you can do to lessen the impact



INHERITANCE TAX (IHT) is a levy that doctors often overlook – perhaps because it is thought that usually it is after your death that most liabilities arise.

But liabilities to IHT can and do occur while you are still living. The good news is that, in many cases, planning can be adopted to reduce the impact of this tax.

No doubt, as you build your successful practice, your wealth will increase and therefore it is important that attention is given to this aspect of wealth planning.

The most common scenario for the payment of IHT is on death where your estate is in excess of the tax-free allowance. At the time of writing, this was £325,000 per

individual. It is known as the 'Nil Rate Band' (NRB).

Most assets are subject to IHT on death, but there are specific exemptions in relation to business and agricultural assets. The largest asset subject to IHT in most people's estates is their home.

Changes were made in October 2007 to allow any unused relief from one individual to pass to their spouse or civil partner.

This is an effective planning tool, as the second death will have a higher NRB on death, perhaps up to £650,000, based on current rates. In the past, many people used a trust to achieve a similar result.

It is worth noting that, upon death, there is no limit to how much can be passed to your spouse or civil partner without any IHT payable, provided you are both UK-domiciled.

However, if you are wealthy, it would be worth discussing your circumstances with a professional adviser, as the surviving spouse could be left with a substantial estate.

Once the NRB has been used up, IHT is charged at 40% on the amount in excess of the NRB.

Certain transactions made while you are living are also subject to IHT. Some create a liability to IHT immediately; others are contingent on the length of time from the gift/transfer and your death.

Making lifetime gifts

Within the framework of IHT, there are measures in place to prevent an individual giving away their estate on the run-up to their death to avoid or minimise the

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tax. Transactions such as these are commonly where parents give away assets to their children. These are known as 'Potentially Exempt Transfers'.

They do not suffer IHT on the initial transfer, but, should the worst happen, they are brought back into the valuation of the estate on death.

Seven-year deadline

Basically, if the person making the gift/transfer lives seven years from the gift, then there is no IHT to pay on subsequent death.

If death occurs within two years of the gift, then 100% of the amount is brought into the death estate, but, following this, it reduces by 20% a year, becoming 0% after seven years.

For example, the surviving parent of Mr X transfers a holiday home worth £500,000 to their only son. Unfortunately, the parent dies after three-and-a-half years, leaving a residual estate in excess of the NRB available to them.

In this example, a further £400,000 (80% of £500,000) is added to the estate on death, and IHT of £160,000 would be payable by the estate – 40% of £400,000.

But, if the transfer had been made earlier to plan for IHT liabilities, this could have been reduced or eliminated altogether. The additional tax could have been avoided if the transfer had been made four years earlier.

Care must be taken where the asset being transferred is the parent's home in which they continue to live, because this may present issues in relation to mak-

ing 'gifts with reservation' which are subject to anti-avoidance measures by HM Revenue and Customs.

If the purpose of the transfer is to shield the home from nursing home fees, then you may fall foul of HMRC in relation to IHT, the local authority or both if you do not consider all the issues. If you are considering transferring your parent's home into the name(s) of the children, you should take professional advice.

If the person making the gift has a significant income, gifts can be made out of surplus income free of IHT, provided that their underlying assets have not been depleted and standard of living is maintained.

For example, if a consultant retired on a pension of £70,000 a year and gave their child £1,000 a month to assist with living expenses out of their surplus income, this would not be a potentially exempt transfer and so it would be free of IHT.

There are also several situations where gifts can be made from one's estate without any IHT implications. These are:

- £3,000 per donor per year to anyone or in total;
- £250 – small gifts (for each recipient);
- Gifts in consideration of marriage. The amount depends on your relationship to the person getting married – for example, £5,000 for a son/daughter;
- Gifts to charities are also given favourable treatment for IHT, but you may want to consider making lifetime gifts to obtain Gift Aid for both you and the charity.

Business assets

Trading businesses are given special consideration for IHT. This could be a sole-trader business, partnership or shares in a personal limited company.

If your private practice business

has a value, then this may be an important area to consider.

The relief available is known as Business Property Relief (BPR). Any assets qualifying for BPR are not subject to IHT. However, there are criteria to be met to receive the relief. Your accountant will be able to discuss this further with you.

Trusts

Gifts/transfers into trusts can be chargeable at the time of transfer and the trust itself may have to pay IHT over a period of time as well.

Following sweeping changes in 2006 to the way in which trusts are taxed, trusts and their use has become more restricted.

Trusts are still used widely and, due to their complex nature, you should seek professional advice if you are considering using one as part of your IHT planning.

Tax residency

If you are domiciled in the UK, your worldwide assets are subject to IHT. If you are not domiciled in the UK, only your UK assets are subject to the tax.

Domicile can be a complex area and therefore your accountant will be able to discuss your individual circumstances in more detail. See feature on page 32.

Inheritance tax should not be ignored as you build your wealth. In many cases, planning during your lifetime can reduce the amount of tax paid on death, protecting your hard-earned estate.

If your estate is in excess of the Nil Rate Band, it is worth speaking to a professional adviser to discuss your circumstances in more detail.

Next month: Recap on trading structure

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MEDICAL PRACTICE VALUATION

18 MAY 2011, ROYAL SOCIETY OF MEDICINE, LONDON

A detailed practical and interactive course on medical practice valuation. Topics to be covered include:

- Difference between personal, locational and free goodwill
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Refreshments and lunch will be provided.

For further information, please contact Maggie Stitt on 01522 546606 or email mstitt@stanbridgeaccountants.co.uk

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