

CHARITABLE GIVING UNDER A WILL

Many people choose to support certain favoured charities in their Wills. In 2012, the government added an incentive in the form of a reduction in the inheritance tax (“IHT”) rate on death if certain conditions are met. In summary, leaving 10% of your estate to charity can reduce the IHT rate on all or part of your chargeable estate from the usual 40% to 36%. This seems to be a win-win situation, but is it too good to be true and how can you benefit from it?

WHAT IS THE REDUCED RATE OF IHT AND HOW DOES IT WORK?

The basic position is that if you leave 10% or more of your estate, or a component of your estate, to a charity or community amateur sports club then, as well as the charitable gift itself being free of IHT in the usual way, the IHT payable on the chargeable estate (or the relevant component) will be 36% rather than the usual 40%. The charitable gift can be given as a legacy of a specific amount or as a proportion of your estate. It is possible for certain beneficiaries or trustees to achieve the same results by making charitable dispositions in the two years following death.

To establish whether or not the reduced IHT rate is available in relation to some or all of your estate, the estate is split into three components: the survivorship component (those assets which were owned as joint tenants); the settled property component (assets which were held in a trust of which you were the life tenant); and the general component (all other assets in your estate for IHT purposes, unless they are simply deemed to be in your estate because you continued to benefit from them after giving them away). In order to apply the lower rate of IHT, the “charitable giving condition” will need to be met by at least one component of the estate. The lower rate then automatically applies to that component, although it is possible to opt out. It may be worth considering opting out where the administrative burden outweighs the benefit of the 4% IHT saving.

If the charitable giving condition is met by one component an election can be made to merge that component with either or both of the other two components of the estate or with assets in which the deceased has reserved a benefit. The merged components are then treated as a single component, and if the charitable giving condition is still met then the lower rate of IHT can be applied to the entirety of the newly merged component.

FACTORS TO CONSIDER BEFORE LEAVING A SIGNIFICANT GIFT TO CHARITY

Although leaving at least 10% of your estate (or a component of your estate) by way of charitable legacy will result in an overall IHT saving, it is important to be aware that it also means that non-charity beneficiaries (often your friends and family) will receive less than if there was no charitable legacy at all. It is therefore worth considering carefully whether this is something you want to include in your will.

On the one hand, you can continue to support your chosen charities after death, and there is a potential IHT saving for your estate. On the other hand, it is difficult to know in advance what size of charitable legacy will be required to obtain the relief. There can also be a heavier administrative burden on executors or trustees in trying to deal with the charitable reduction, and making decisions about whether to merge components or opt out of the reduced rate.

FINAL THOUGHTS...

Leaving 10% of your estate to charity may seem like a simple solution to achieving your philanthropic aims and reducing your IHT bill but the calculations in relation to qualifying assets can be complicated and lead to unanticipated administrative consequences for your personal representatives.

KEY CONTACTS

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