Later Life Finance

Lifetime Mortgages and IH Tax

Unlocking the wealth in your home could reduce the impact of inheritance tax on your estate

Family wealth can take generations to build; it's logical to plan ahead to ensure the impact of inheritance tax is minimised. Inheritance tax is charged at 40% and the tax-free allowance has been set at £325,000 per person until 2026. Recent significant property inflation has seen many homeowners being caught in the 'inheritance tax trap'. Families only have 6 months to settle inheritance tax when it is due payable.

Retirement & Lifetime Mortgages can provide a flexible method of raising property wealth for retirement & lifestyle spending, home improvements, passing on an early inheritance to loved ones, and also for care in the home funding.

Gifting a 'living inheritance' to distribute wealth to family members via later life mortgages can be beneficial for inheritance tax planning purposes by reducing the value of the estate when the mortgage is eventually repaid. The seven-year rule for inheritance tax is a prime consideration for gifting funds, as any gifts made within 7 years of death are taken into consideration when calculating inheritance tax.

The house price gap with younger people effectively being 'priced out' of the market also makes a strong case for utilising equity to assist families with home deposits, or funding grandchildren's education fees.

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How can a *Lifetime Mortgage* be used for gifting an inheritance?

Lifetime mortgages can be used to gift a 'living inheritance' to family members whilst you are still alive.

A living inheritance is method of passing on some of your wealth to your family whilst you are living and can enjoy the benefits of helping loved ones. This is known as intergenerational wealth distribution.

Gifting an early inheritance can be done via special mortgages to safely unlock tax-free equity from your home. Repayments are optional, and home ownership is retained for life. You can still downsize if you wish.

Because the mortgage is deducted from your estate on death, this reduces the impact of inheritance tax. Assuming the gift is made more than 7 years prior, the money gifted is not taking into consideration for IH tax purposes. Due to the 7-year rule, the earlier any gifts are made, the better.

Case study of *Equity Release* & Inheritance Tax Planning

Mr Cook is a retired solicitor and enquired about reducing his inheritance tax liability. He is widowed. He owns a property worth £1.2 million and has other assets of £400,000. He has two daughters who will be the sole beneficiaries of his estate.

Without any IHT planning his daughters could be faced with a large IH tax bill.
Mr Cook wanted to gift an early inheritance to his daughters. Releasing equity with a lifetime mortgage, he was able to help his daughters with their own property purchases. Based on his life expectancy the projected mortgage sum repayable upon death including interest is £600,000. Providing Mr Cook lives for at least seven years, the gifts fall outside of his estate for inheritance tax purposes.

	Before equity release	**After equity release**
Estate	£1,600,000	£1,000,000
Less joint nil rate band	£650,000	£650,000
Less joint residence nil rate band	£350,000	£350,000
Taxable estate	£600,000	£0
IHT liability	£240,000	£0

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Your *Questions* answered

How does Equity Release save Inheritance Tax?

Gifting funds via a lifetime mortgage can reduce your inheritance tax bill. The money borrowed via the mortgage is deducted from your estate upon death or long term care, which helps reduce any tax due payable. If you make a gift and survive for 7 years or more, the gift can be tax-free.

Is Equity Release Tax free?

Equity release is tax free and not subject to Income Tax as it is not a form of income, as it is a mortgage. Since the lending is taken out against your home, this is not taxable for income or capital gains tax. Even if you are planning to Release Equity to supplement your income, you are not subject to any taxation on the money released.

What are the rules for married couples and civil partnerships?

When you die, assets left to your spouse or registered civil partner are exempt from inheritance tax, provided they're living in the UK. In addition to this, your partner's inheritance tax allowance rises by the percentage of your allowance that you didn't use, therefore a a couple can currently leave £1 million tax-free (2 x £325,000 tax-free allowances + 2 x £175,000 main residence allowances).

How does Equity Release work when someone dies?

Equity release is repaid within 12 months of the last surviving homeowner passing away or going into long term care. On first death or long term care, the plan continues until the surviving homeowner passes away or goes into long term care. Then the property is sold and the plan is settled.

The executors of your estate will have control over marketing the property with an estate agent. When the property is sold, the outstanding balance owing is settled and after any professional fees such as legal costs are settled the residual balance will be paid to your estate

Is Equity Release Subject to Inheritance Tax?

Equity release is not subject to inheritance tax if any gifts made meets the 7 year rule criteria. As the money borrowed plus interest is deducted from your estate upon death or long term care, this helps reduce any tax due payable.

Equity release is an option for older homeowners to consider if distributing the wealth to family is a consideration. For many people their home will form most of their estate, which ultimately makes this an important decision to make.

How is Inheritance Tax calculated?

Inheritance tax is a tax due on the estate of someone who's died.
The amount of tax due depends on the value of the deceased's estate – which is worked out based on their assets (cash in the bank, investments, property or business, vehicles, payouts from life insurance policies), minus any debts including mortgages and equity released from their home.

Your *Questions* answered Continued

There is normally no IH tax to pay if: The total value of your estate is below £325,000, OR
You leave everything over £325,000 to your spouse, civil partner, a charity or an amateur sports club
If neither of the above apply, your estate will be taxed at 40% on anything above the £325,000 threshold when you die (36% if you have left at least 10% of the value after any deductions to a charity in your will).

What is the 'Residence Nil Rate Band'?

The residence nil-rate band is £175,000 for the 2020/2021 tax year. Beginning in the 2021/2022 tax year, the band will increase every year in line with inflation, as measured by the Consumer Price Index.

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Later Life Finance provides an independent advice later life mortgage broker service to clients over 55 throughout the UK. We do not provide tax advice.

Book a free appointment with a later life mortgage expert

0800 2465228

advice@later-life-finance.co.uk

www.later-life-finance.co.uk

Taking an equity release lifetime mortgage may impact on current and future entitlement to means tested state benefits. Ask for a personalised illustration to understand the risks.

Lifetime mortgages have voluntary repayment options which enable the balance to be maintained if desired. We provide detailed illustrations and projections to help you understand whether this is a suitable solution for your requirements.

Later Life Finance Ltd is registered in England and Wales no. 09320116.
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