J H GREENWOOD & COMPANY

CHARTERED ACCOUNTANTS

Inheritance Tax - A Summary

FACTSHEET

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Inheritance Tax (IHT) is levied on a person's estate when they die and certain gifts made during an individual's lifetime.

In this factsheet the term spouse includes married couples and registered civil partners. Generally, gifts between spouses are exempt. More detail on this aspect and other specific exemptions is included below. Where an exemption does not apply, most gifts made more than seven years before death will also escape tax. Therefore, if you plan in advance, gifts can be made tax-free and result in a substantial tax saving.

We give guidance below on some of the main opportunities for minimising the impact of the tax.

It is however important for you to seek specific professional advice appropriate to your personal circumstances.

Summary of IHT

Scope of the tax

When a person dies IHT becomes due on their estate. IHT can also fall due on some lifetime gifts but most are ignored providing the donor survives for seven years after the gift.

The rate of tax on death is 40% and 20% on lifetime transfers where chargeable. Currently, the first £325,000 is chargeable to IHT at 0% and this is known as the nil rate band.

Residence nil rate band

An additional nil rate band was introduced for deaths on or after 6 April 2017 where an interest in a qualifying residence passes to direct descendants.The amount of relief was initially phased in but is currently £175,000. For many married couples and registered civil partnerships (hereafter referred to as spouses in this factsheet) the relief is effectively doubled as each individual has a main nil rate band and each will also potentially benefit from the residence nil rate band.

The residence nil rate band can only be used in respect of one residential property which does not have to be the main family home but must at some point have been a residence of the deceased. Restrictions apply where estates (before reliefs) are in excess of £2 million.

Where a person died before 6 April 2017, their estate will not have qualified for the relief and if the first spouse has died since then they may not have used the relief. A surviving spouse may be entitled to an increase in the residence nil rate band if the spouse who died earlier has not used, or was not entitled to use, their full residence nil rate band. In fact this often results in a doubling of the residence nil rate band for the surviving spouse.

Downsizing

The residence nil rate band may also be available when a person downsizes or ceases to own a home on or after 8 July 2015 where assets of an equivalent value, up to the value of the residence nil rate band, are passed on death to direct descendants.

Charitable giving

A reduced rate of IHT applies where 10% or more of a deceased's net estate (after deducting IHT exemptions, reliefs and the nil rate band) is left to UK charities. In those cases the 40% rate will be reduced to 36%.

IHT on lifetime gifts

Lifetime gifts fall into one of three categories:

- a transfer to a company or a trust (except a disabled trust) is immediately chargeable
- exempt gifts which will be ignored both when they are made and also on the subsequent death of the donor, eg gifts to charity
- other outright transfers will be potentially exempt transfers (PETs) and IHT is only due if the donor dies within seven years of making the gift. An alternative way of looking at this is that they are potentially chargeable until seven years has passed. The primary example of a PET is a gift to another individual.

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IHT on death

The main IHT charge is likely to arise on death. IHT is charged on the value of the estate treated as beneficially owned by the deceased. This may include certain types of interest in trust property. Furthermore:

- PETs made within seven years become chargeable
- there may be an additional liability because of chargeable transfers (usually lifetime gifts to trusts) made within the previous seven years.

Estate planning

Much estate planning involves making lifetime transfers to utilise exemptions and reliefs or to benefit from a lower rate of tax on lifetime transfers.

However, careful consideration needs to be given to other factors. For example a lifetime gift may save IHT but may alternatively create a Capital Gains Tax (CGT) liability. Furthermore the prospect of saving IHT should not be allowed to jeopardise the financial security of those involved.

Gifts between spouses

Gifts between spouses as stated earlier are generally fully exempt, if both are either UK 'long term resident' or both non 'long term resident'. Long term residence is residence of at least 10 years in the UK. Special rules apply where only one spouse is 'long term resident and it means that the spouse exemption may be restricted. It is recommended that advice is always sought if this applies to ensure reliefs are maximised. It may be desirable to use the spouse exemption to transfer assets to ensure that both spouses can make full use of lifetime exemptions, the nil rate band and PETs.

Gifts to individuals during their lifetime

As these gifts are PETs rather than chargeable transfers when made, no tax at all is due if the donor survives for seven years. Even where a death occurs within seven years IHT may be saved as a result of the lifetime gifts because the charge is based on the value at the date of the gift and does not include any growth on value to date of death.

These rules only apply to outright gifts. Where a benefit is retained, such as the gift of a house in which the donor continues to live rent free, special rules apply and the donor is treated as still owning the asset for IHT. Professional advice should always be taken before considering such actions.

Nil rate band and seven year cumulation

Chargeable transfers (such as lifetime gifts to trusts) covered by the nil rate band can be made without incurring any IHT liability. Once seven years have elapsed between chargeable transfers an earlier transfer is no longer taken into account in determining IHT on subsequent transfers. Therefore every seven years a full nil rate band will be available to make lifetime chargeable transfers.

Transferable nil rate band

It is possible for spouses and civil partners to transfer the nil rate band unused on the first death to the surviving spouse for use on the death of the surviving spouse/partner. On that second death, their estate will be able to use their own nil rate band and in addition the same proportion of a second nil rate band that corresponds to the proportion unused on the first death. This allows the possibility of doubling the nil rate band available on the second death. This arrangement can apply where the second death happens after 9 October 2007, generally irrespective of the date of the first death.

Annual exemption

An amount of £3,000 per annum may be given by an individual without an IHT charge. Any unused annual exemption may be carried forward one year only, for use in the tax year that immediately follows.

Small gifts

Gifts to individuals not exceeding £250 in total per tax year per recipient are exempt. The exemption cannot be used to cover part of a larger gift.

Normal expenditure out of income

Gifts which are made out of income which are typical and habitual and do not result in a fall in the standard of living of the donor are exempt. Payments under deed of covenant and the payment of annual premiums on life insurance policies would usually fall within this exemption.

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Family maintenance

A gift for family maintenance does not give rise to an IHT charge. This would include the transfer of property made on divorce under a court order, gifts for the education of children or maintenance of a dependent relative.

Wedding presents

Gifts in consideration of marriage are exempt up to £5,000 if made by a parent with lower limits for other donors.

Gifts to charities

Gifts to UK registered charities are exempt provided that the gift becomes the property of the charity or is held for charitable purposes.

Business property relief (BPR)

When 'business property' is transferred there is a percentage reduction in the value of the transfer. Often this provides full relief. It is available on worldwide assets. In cases where full relief is available there is little incentive, from a tax point of view, to transfer such assets in lifetime. Additionally no CGT will be payable where the asset is included in the estate on death. Professional advice should be sought to determine whether you have qualifying business property.

Agricultural property relief (APR)

APR is similar to BPR in that it reduces the value of the transfer but it may not give full relief on the value. It is available on the transfer of agricultural property so long as various conditions are met. APR is restricted to UK assets only from April 2024.

Restriction on BPR and APR

From 6 April 2026, qualifying agricultural and business property will continue to benefit from the 100% IHT relief up to a limit of £2.5 million. The limit is a combined limit for both agricultural and business property. Such property in excess of the limit will benefit from a 50% relief. This allowance will be transferable between spouses and civil partners.

The changes may have a significant impact for some clients. Please contact us to discuss if you have business or agricultural interests in excess of £2.5 million.

Use of trusts

Trusts can provide an effective means of transferring assets out of an estate whilst still allowing flexibility in the ultimate destination and/or permitting the donor to retain some control over the assets. Provided that the donor does not obtain any benefit or enjoyment from the trust, the property is removed from the estate.

We can advise you on whether a trust is suitable for your circumstances and the types of trust arrangements available.

Life assurance

Life assurance arrangements can be used as a means of removing value from an estate and also as a method of funding IHT liabilities.

A policy can also be arranged to cover IHT due on death. It is particularly useful in providing funds to meet an IHT liability where the assets are not easily realised, e.g. family company shares.

Complexity - is your Will up to date?

Individuals have both a nil rate and a potential residence nil rate band available to mitigate IHT. Careful consideration is needed by spouses as to whether these should be used in full or part on the first spouse death or whether they should be transferred to the second spouse for use. There are a number of factors to be considered including the overall value of the combined estate. Potentially a second spouse has £650,000 of standard nil rate band and £350,000 of residence nil rate band if nothing is used on the first death, in other words £1 million in total before IHT is chargeable.

This will only be achieved by careful planning however and, in some cases, it may be better for the first deceased spouse to give some assets to the next generation and use up their own nil rate band and residence nil rate band. Pivotal to this planning is an up to date Will to ensure that any reliefs available are efficiently utilised.

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How we can help

Whilst some general tips can be made about IHT planning it is always necessary to tailor the strategy to fit your situation.

Any plan must take account of your circumstances and aspirations. The need to ensure your financial security (and your family's) cannot be ignored. If you propose to make gifts the interaction of IHT with other taxes needs to be considered carefully.

The scope for substantial savings may be missed unless professional advice is sought as to the appropriate course of action. We would welcome the opportunity to assist you in formulating a strategy suitable for your own requirements. Please do not hesitate to contact us.

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