

## **Inheritance Tax – Fact Sheet**

Inheritance tax (IHT) is often called a voluntary tax in that, with planning, the payment of IHT can be avoided.

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

Gifts between UK-domiciled spouses during their lifetime and on death are exempt from IHT. (In this factsheet 'spouse' includes married couples and registered civil partners).

Certain gifts made more than seven years before death will be tax free.

Therefore, if you plan in advance, gifts can be made tax free and result in a substantial tax saving.

### **Summary of Inheritance Tax**

#### **Scope of the Tax**

When a person dies IHT is due on their estate at 40% (subject to certain exemptions and reliefs). An estate may include certain types of interest in Trust property.

When a gift is made during lifetime IHT can also be due (subject to certain exemptions and reliefs):

- Chargeable Lifetime Transfer (CLT) I.e. transfer into most Trusts, at 20%
- Potentially Exempt Transfer (PET) I.e. gift to an individual, no IHT is payable as long as the person making the gift survives for 7 years

If the person making the gift/transfer dies within 7 years of the date of the gift additional tax may be levied.

#### **Nil Rate Band**

For 2020/21 the first £325,000 of a person's chargeable estate is tax free and is called the nil rate band.

This nil rate band is applied to Chargeable Lifetime Transfers as well as Estates on Death.

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For spouses: on the death of the second spouse, where the first spouse did not use all of his/her nil rate band, that unused percentage of the nil rate band can be used on the second death. This is called the **Transferable Nil Rate Band**.

Example:

If George dies in 2017/18 leaving all of his estate to his wife Gill having made no lifetime gifts, none of his nil rate band will be used as gifts to UK domiciled spouses are exempt for IHT purposes.

When Gill dies, in 2020/21, her executors will have both Gill's own and 100% of George's nil rate band to reduce her chargeable estate ( $2 \times £325,000 = £650,000$ ).

### **Residence Nil Rate Band**

It is not unusual for a married couple's estate to be made up predominantly of the family home which appreciates in value with each year that passes. In London, as of June 2020, the average house price stood at close to £675,000.

The residence nil rate band applies to residential property left by Will, only, to a direct descendant i.e. a child/grandchild.

For 2020/21 the residence nil rate band is set at £175,000 per individual.

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.

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.

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. The calculations involved are potentially complex but the increase will often result in a doubling of the residence nil rate band for the surviving spouse.

Example:

George and Gill lived in their marital home for 40 years. On George's death in 2017/18 the marital home passed to Gill (George's residence nil rate band was not used as the marital home passed to his spouse).

On Gill's death, in 2020/21, she leaves the marital home (valued at £400,000) to their only child Joe. The executors will have both Gill's own and 100% of George's residence nil rate band to set against the chargeable estate ( $2 \times £175,000 = £350,000$ ).

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## **Charitable Giving**

Gifts to charity in lifetime or on death are exempt from IHT.

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 charity.

In those cases the 40% rate will be reduced to 36%.

## **Estate Planning**

Much estate planning involves the making of lifetime transfers to utilise exemptions and reliefs or to benefit from lower rates of tax.

However, careful consideration needs to be given to other factors both relating to tax and otherwise.

The financial security of the individual is of prime importance.

A gift that saves IHT may create a Capital Gains Tax (CGT) liability which negates the potential IHT saving. A transaction must be looked at in the round.

## **Gifts to Individuals during Lifetime (PET's)**

These gifts are:

- IHT free when made
- IHT free if the person making the gift lives for 7 years from the date of the gift.
- If the person making the gift dies within 7 years of the date of making the gift an IHT liability arises. This is based on a sliding scale with more recent gifts taxed at a higher rate. A further complexity arises in determining the amount of the nil rate band available in these circumstances. Any IHT is payable by the person receiving the gift.

Even where a death occurs within seven years IHT may be saved as a result of the lifetime gift because the IHT charged is based on the value at the date of the gift, it does not include any growth in value between that date and the date of death.

## **Chargeable Lifetime Transfers (CLT's)**

The value transferred for IHT purposes is the 'loss to the donor's estate' as a result of the transfer, which is not always the same as the amount that the donee receives.

Where a CLT is made it is only immediately chargeable to IHT if it is not covered, cumulatively, by the nil rate band (2020/21: £325,000)

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If IHT is immediately chargeable it is at a rate of 20%

When assessing if a transfer is covered (at least in part) by the nil rate band a record must be kept of all gifts/transfers made by the individual in chronological order. A gift/transfer falls out of the reckoning after 7 years.

If the person who made the CLT dies within 7 years of making it an IHT charge of 40% is charged with credit being given for the IHT paid at the date of transfer. The rate reduces according to the time between the date of gift and death.

The IHT at death is charged on the trustees.

### **Exemptions applying to Lifetime Transfers Only**

#### **Annual exemption:**

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

#### **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 and are 'typical and habitual' and do not result in a fall in the standard of living of the donor are exempt.

#### **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 a lower limit of £1,000 for other donors.

### **Exemption applying on Lifetime and Death Transfers**

#### **Gifts between spouses:**

**Transfers of any amount to a UK domiciled spouse/civil partner or between non-UK domiciled spouses/civil partners are exempt.**

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**Transfers by a UK domiciled spouse/civil partner to a non-UK domiciled spouse/civil partner up to the prevailing nil rate band (currently £325,000) are exempt. An election can be made by the non-UK domiciled spouse/civil partner to be treated as UK domiciled for the purpose of IHT. If such an election is made, it allows an unlimited exemption for transfers of property between spouses/civil partners, but it also brings the whole estate of the non-UK domiciled spouse/civil partner into the UK inheritance tax regime.**

### **Gifts to charities:**

Gifts to registered charities are exempt.

## **Reliefs applying on Lifetime and Death Transfers**

### **Business property relief (BPR)**

When 'business property' is transferred there is a percentage reduction in the value of the transfer for IHT purposes.

The definition of relevant business property is given in Section 105 IHTA 1984.

The percentage reduction is either 100% or 50% depending on the nature of the business property. The relief is given automatically if the qualifying conditions are met.

Professional advice should be sought to determine whether you have qualifying business property.

BPR is given before annual exemptions.

### **Agricultural property relief (APR)**

APR is similar to BPR in that it reduces the value of the transfer by 100% or 50% of the agricultural value.

However, the agricultural value of property may be different to the market value and it may not give full relief from IHT.

APR is available at 100% to a farmer who owns farmland and farm buildings and uses these assets in his farming business.

## **Use of Trusts**

Trusts can provide an effective means of transferring assets out of an estate whilst still allowing flexibility in their ultimate destination.

Provided that the donor does not obtain any benefit or enjoyment from the trust, the property is removed from the estate.

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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.

They are a particularly useful method of providing funds to meet an IHT liability where the assets are not easily realised e.g. family company shares.

### **Ensure your Will is up to date**

This is an extremely complex area.

Over the last 15 years changes to the availability of the nil rate band and the introduction of the residence nil rate band have resulted in spouses being able to utilise, from 2020/21, a total combined nil rate band of £1 million.

Where a Will often used to be made once in a lifetime it is now essential that a Will, once made, is reviewed on a periodic basis to ensure that it takes advantage of the most appropriate and up to date legislation in respect of IHT.

Qualifying for the full extent of these nil rate bands can only be achieved by careful planning and, in some cases, it may be better for the first deceased spouse to gift some assets to the next generation and use up some or all of the available nil rate bands.

For many individuals, the residence nil rate band will be of considerable importance (due to the continuing increase in the value of the family home), however, individuals will need to revisit their Wills to ensure that the relief will be available to their estate and that it is efficiently utilised.

### **How we can help**

IHT is an extremely complex tax.

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

Any plan must take account of your circumstances and aspirations.

The need to ensure your financial security (and that of your family) is paramount.

In making gifts the interaction of IHT with other taxes needs to be considered carefully.

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There can be scope for substantial tax savings which may be missed if professional advice is not sought.

We, at Clear Accountancy and Tax, are here to help. Contact Tina on 07986264512 to discuss your situation and concerns.

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