FOCUS ON

IHT

What is Inheritance Tax (IHT)?

IHT may be payable on an individual's estate on death or on certain gifts made during their lifetime. IHT is payable on chargeable transfers of value made by a person during their lifetime or on the value of their estate on death. For IHT purposes when a person dies they are deemed to have made a transfer of all their property. Although some people may become liable for IHT during their lifetime on any chargeable lifetime transfers, the majority of people will only become liable to pay IHT on their death.

What rate of Inheritance Tax is payable?

The rate of tax chargeable on lifetime transfers is 20%. The rate of tax on death is 40%.

IHT will only become payable if the chargeable transfer exceeds the Nil Rate Band (NRB). The current NRB for the tax year ending April 18 stands at £325,000.

It is now possible for spouses and civil partners to transfer any part of the NRB which is unused when the first spouse/civil partner dies to the individual's surviving spouse/civil partner.

Therefore on the death of the surviving spouse/civil partner their NRB will be increased by the proportion of the unused NRB of their partner.

What is a transfer of value?

Any gratuitous transaction or gift which reduces the value of an estate of an individual is a transfer of value. Every transfer of value is chargeable to IHT unless it is specifically exempt. The value of the transfer is the reduction in value of the estate. This is mostly, but not always, the value of the asset being transferred. The transfer of value can be made during lifetime or on death. Transfers of value can be categorised as Lifetime Chargeable Transfers, Potentially Exempt Transfers or Exempt Transfers.

Lifetime Chargeable Transfers

Tax is payable on Lifetime Chargeable Transfers at the time of transfer. The tax is charged at 20%. A transfer becomes chargeable if it is not specifically exempt or if it is a potentially exempt transfer. Generally only a gift into a trust will be a lifetime chargeable transfer.

Exempt Transfers

If a transfer is specifically exempt then it is never liable to IHT. With a bit of planning you can use the exemption categories to mitigate or reduce your IHT bill. The exempt categories are as follows:

a. Transfers between Spouses and Civil Partners

Any estate passing to your spouse/civil partner will be exempt from IHT. This is obviously a very useful tool for tax planning purposes. It should be used in conjunction with the rule on transfer of unused NRBs between spouses/civil partners.

b. Annual Exemption

You are allowed to make lifetime gifts not exceeding £3,000 in any tax year (i.e. total gifts made). You are allowed to carry this exemption forward for one year. You can bring forward all or any part of the exemption unused from the preceding tax year.

c. Small Gift Exemptions

Outright gifts (gifts with no strings attached) of up to £250 to any one person are exempt. There is no limit to the number of persons to whom these gifts can be given as long as each person doesn't receive more than £250. This exemption doesn't apply to transfers on death or transfers to or from a trust.
This exemption cannot be used in conjunction with the annual exemption.

d. Lifetime Gifts in Consideration of Marriage or Entering a Civil Partnership

These are exempt to the following extent:

- By each parent to his or her child up to £5,000
- By a grandparent up to £2,500
- By any other person up to £1,000

Therefore each parent may gift their child £5,000 on the occasion of their child's marriage i.e. the child receives £10,000 in total.

e. Charitable Bequests

All gifts (either made on death or during lifetime) made to charities, political parties and bequests to certain bodies concerned with the preservation of the National Heritage or of a public nature (e.g. Universities, The National Trust etc.) are exempt.

To qualify for this exemption the charity must be a registered charity.

f. Normal Expenditure

Lifetime gifts which represent normal expenditure out of income are exempt. To qualify the gift must be made regularly and out of income, not capital. Furthermore you must demonstrate that the donor's standard of living was not adversely affected and the source of the funds used to make the gift need to be considered carefully.

g. Maintenance Gifts

Lifetime gifts for the maintenance of children who are under 18 or in full time education, for dependent relatives, spouse/civil partner or for ex spouse/civil partner are exempt.
Types of things that will be included under this exemption will be payments to a life insurance policy, gifts at birthdays, Christmas and anniversaries.

Potential Exempt Transfers (PETs)

If a gift is not a lifetime chargeable transfer or exempt then it will be a PET. No IHT is immediately due at the date the gift is made. IHT will only become due if the donor doesn't survive for 7 years from the date of the gift. If the donor does survive 7 years the gift will not be taken into account in calculating the IHT. Please note it is the recipient not the donor who becomes liable to pay the IHT.

The amount of IHT due on such gifts depends on the length of time which has elapsed from the date of gift to the date of death. The longer the donor has survived the less tax will be due. The tax charged will be at the rate applicable at the date of death, however, the rate will be subject to taper relief which reduces the rate according to the years of survival. Please be aware that lifetime gifts that become chargeable on death will reduce any nil rate band available before being tapered.

Years between gift and death	% of charge at death rate
0-3	100
3-4	80
4-5	60
5-6	40
6-7	20

Reliefs available

There are certain reliefs available which will reduce your IHT bill.

i. Agricultural Property Relief

For a working farm the relief is 100% and for certain let agricultural property the relief is 50%. It is given on the value of the agricultural property which means land and buildings occupied for agricultural purposes. It doesn't include livestock, dead stock or farm implements but these may qualify for business property relief.

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ii. Business Property Relief

There is relief of 100% on business property as long as the property has been owned for 2 years. Business property relief extends to unquoted shares, forestry and agricultural land and shares listed on the AIM (Alternative Investment Market). For the person trying to mitigate IHT these assets may be worth investing in.

iii. Woodlands Relief

There is a specific 100% relief for transfers of woodland on death. This relief relates to the value of the timber (the trees and the underwood) but not to the underlying land. However the land could benefit from agricultural or business property relief.

iv. Quick Succession Relief

If a person inherits an asset on the death of another and then dies within a short space of time that asset will suffer IHT again on the second death. Quick Succession Relief mitigates this double taxation by giving a reduction on IHT payable on the asset on the second death.

The amount of relief is 100% if the second death occurs within 1 year of the first death with a sliding scale of relief up to a maximum of 5 years.

Gifts with Reservation

Although gifting property can be a useful tool in reducing the IHT liability you must ensure that any gift is an outright gift.

An outright gift is where the gift is given to the recipient with no strings attached and they receive the full benefit of the asset gifted.

A good example of a gift with reservation is where a mother gifts a house to her son but continues to live in the house until she dies, without paying market rent.

In this scenario the transfer of the house will not count as a gift for IHT purposes. In effect the house will still form part of the mother's estate on death.

There may also be income tax implications of a gift with reservation. If you continue to receive benefits from certain types of property which you previously owned income tax will be payable on this benefit.

Making a Will

The importance of making a will can not be stressed heavily enough. Besides mitigating IHT it ensures the assets go to the person the deceased would like them to go to. Drawing up a will also ensures that as little as possible will go to the tax man. It is also imperative to keep updating your will as your life and assets change.

Recent Changes

A new tax allowance for home owners has been introduced in April 2017. The family home allowance which will eventually be worth £175,000 per person will be available and will also be transferable between spouses/civil partners.

It will be introduced gradually over 4 years as follows:

£100,000	2017/18
£125,000	2018/19
£150,000	2019/20
£175,000	2020/21 and thereafter

For estates worth more than £2m the new home allowance will be tapered by £1 for every £2 over the £2m threshold. To qualify the property must have been the main home at some point and left to direct descendants which includes children, step children, adopted children, foster children and grandchildren.

Contact us
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