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Introduction

The death of a relation or close friend presents a new set of practical problems at a time when the family may be least able to cope. This leaflet is written to provide guidance to those who will be involved in the period after someone dies, whether they are appointed as Executors under a Will or just close family who may be involved in organising a funeral. The guide is not meant to be comprehensive, but we hope it will outline the processes involved, help to remove some of the mystery and explain the jargon used in this area.

In principle, the value of an individual's estate on death (together with the value of any gifts made in the previous seven years) is subject to Inheritance Tax ("IHT") at the rate of 40%.

In practice, there are a number of exemptions and reliefs from IHT which mean that, by sensible

planning, IHT payable on the value of assets at death and lifetime gifts can be greatly reduced.

Advice designed to minimise IHT can be complicated and will always depend on the circumstances relevant to each individual case. For instance, it may relate specifically to lifetime gifts, gifts by Will, the creation of trusts or to a combination of all of these.



HCR Hewitsons has a specialist department to advise on the whole range of Capital Tax planning for both business and private clients. We would therefore be pleased to advise you on your own particular circumstances and to outline some tax planning measures if appropriate.

The purpose of this Guide is to outline how IHT works, and by doing so, help you understand the tax planning advice you have been given, or simply introduce you to the tax.

Part 1: How IHT works

When is IHT actually paid?

Although both lifetime gifts and the value of assets on death are potentially subject to IHT, in the majority of cases IHT is only paid on the death of an individual. This is because the treatment of most lifetime gifts (other than into trusts), for IHT purposes, depends on how long the individual survives after making the gift.

Lifetime gifts

Generally speaking, lifetime gifts (other than into trusts) are exempt from IHT if the donor survives for seven years after making them. They are therefore known as “Potentially Exempt Transfers” or “PETS”.

For gifts made more than three years (but not more than seven years) before death, the rate of IHT may be reduced if the total value of the gifts exceeds the “nil rate band” applicable at the donor’s death. This reduction is known as “taper relief” but in most cases the gifts will simply use up the first part of the available nil rate band exemption on death.

Transfers into trusts (in excess of the available nil rate band) will attract IHT at a rate of 20% unless to a trust for a disabled person.

The total amount of IHT on lifetime gifts (if any) can only be finally calculated when the donor has died. It is therefore sensible to keep a record of all gifts made (with dates) which may subsequently be subject to IHT.

Lifetime gifts where the donor continues to benefit from the asset gifted will continue to be treated as part of the donor’s estate for IHT purposes.

The Nil Rate Band

When an individual dies, the value of his or her assets is added to the value of any non-exempt lifetime gifts made in the previous seven years to calculate the total amount subject to IHT.

In the tax year 2019/2020, the first £325,000 of that total is subject to IHT but at a nil rate and it is therefore known as the “nil rate band”. The remainder of the total is subject to IHT at 40% unless exemptions or reliefs apply.

Residence Nil Rate Band

In his Summer Budget of 8 July 2015, the Chancellor announced that the nil rate band of £325,000 would remain fixed until 5 April 2020, but that an additional nil rate band (the “residence nil rate band”) would be available where a residence is passed on to direct descendants. This new residence nil rate band was introduced in the Finance (No 2) Act 2015. It only applies to deaths occurring on or after 6 April 2017 and the amount will increase over a three year period so that, by April 2020, a couple with a house worth over £350,000 may be able to leave £1 million to their children/grandchildren free of inheritance tax. However, the provisions are complex and in practice

the residence nil rate band will be of limited benefit. A significant limitation is that estates over £2 million will have the residence nil rate band reduced, or disallowed entirely, depending on the size of the estate.

The Transferable Nil Rate Band

The Finance Act 2008 introduced the transferable nil rate band for spouses and civil partners.

A claim can be made on the second death to transfer any unused nil rate band of the first spouse or civil partner to die to the estate of the surviving spouse or civil partner who dies on or after 9 October 2007. This applies where the nil rate band of the first deceased spouse or civil partner was not fully used in their estate. The amount transferred is the proportion unused and at the rate in force at the time of the second death.

Example:

Husband died in 2002/2003 tax year.

Nil rate band was £250,000.

£50,000 of legacies were left to non-exempt beneficiaries (children) under his Will, using 20% of his nil rate band; the remainder was left to his wife and was spouse exempt. 80% of husband's nil rate band was therefore unused.

Wife dies in 2019/2020 tax year.

Nil rate band is £325,000.

80% of husband's nil rate band (at current rate of £325,000) can be transferred.

Wife's estate has total nil rate band of:

£325,000 (her own) + £260,000 (transferred) = £585,000.

If the wife's estate is below £585,000, no inheritance will be payable. (The example assumes no lifetime gifts of relevance).

The above example does not take into account the residence nil rate band, which can also be transferred to the surviving spouse.

Part 2: Exemptions and reliefs from IHT

The total of an individual's lifetime gifts and assets on death which are subject to IHT may be reduced by certain exemptions and reliefs. The main ones are referred to below.

Lifetime gifts exempt from IHT

- The first £3,000 of gifts made by an individual in any one tax year are exempt. If the full £3,000 allowance is not used in one tax year, the unused part (or the whole) may be carried forward but for one tax year only.
- Gifts of not more than £250 each may be made to any number of persons in a tax year (£250 per donee). If any gift exceeds £250 it will form part of the £3,000 allowance referred to in the previous paragraph and may affect other exemptions.
- Gifts which are regular enough to be normal expenditure out of income may be exempt. However, the gifts must be made out of income and leave sufficient income to maintain the usual standard of living of the person making the gift, e.g. the payment of insurance policy premiums on another person's life (or in trust for that person).
- Gifts to children (£5,000 limit per gift) or grandchildren or great grandchildren (£2,500 limit per gift) on their marriage or civil partnership are exempt.

Gifts between spouses and civil partners

All outright gifts between spouses and civil partners (whether during lifetime or on death) are exempt from IHT, except where the donor spouse/civil partner is domiciled in the UK but the recipient spouse/civil partner is not. Special rules then apply.

It can be advantageous to equalise estates between spouses/civil partners for future flexibility of gifts. If one spouse is significantly younger (or healthier) than the other, it makes sense for the bulk of gifts to be made by the younger (or healthier).

Agricultural Property Relief

Property which is occupied for agricultural purposes may receive relief from IHT of either 100% or 50% of its agricultural value. 100% relief is generally available if the individual has the right to vacant possession of the property (or can obtain it within a certain period).

However, there are qualifying periods for ownership of the property before the relief applies. In September 1995 the government relaxed the IHT treatment of tenanted land. Land subject to Farm Business tenancies after that date may qualify for 100% relief. Any non-agricultural value (such as development value) will not qualify.

Business Property Relief

Certain “relevant business property” also qualifies for relief from IHT. This includes a sole trader’s business, a share in a partnership, shares in certain types of company and also land, buildings, plant and machinery used in such businesses. However, investment company holdings and businesses, and land or share-dealing company holdings and businesses, will not usually qualify for the relief.

The rates of relief are 100% or 50%. The 100% rate usually applies to a sole trader’s business, a partnership share or a shareholding of private trading company shares. Again, there is a qualifying period of ownership (currently two years).

Other exemptions

Other exemptions from IHT include gifts to charities, political parties and donations to certain organisations (e.g. the National Trust, British Museum etc).

Reduced rate of IHT

Where a person dies after 5 April 2012 and 10% or more of their net estate is given to charity, a reduced rate of IHT may apply to the rest of the estate which is subject to IHT. The reduced rate is 36% (rather than the normal 40% rate).

Pre-owned assets charge

Legislation introduced in the Finance Act 2004 imposes an income tax charge on some assets (particularly property and chattels) given away under certain arrangements.

Trusts

Following the Finance Act 2006 the creation of a lifetime trust may be immediately chargeable to IHT at lifetime rates (currently 20%). Tax may not be due if the value of the gift is less than the nil rate band but the gift will count towards the total value of lifetime gifts to be calculated on the death of the person creating the trust if that person dies within seven years of establishing the trust.

Most trusts created after 22 March 2006 are also subject to a periodic charge to IHT on each ten-year anniversary of the creation of the trust and on capital distributions. The rate is currently a maximum of 6%.

The creation of a trust for a disabled person (in accordance with the legislation) will not trigger a charge.

Other Taxes

Even where gifts are exempt from IHT, it may be necessary to consider other taxes such as Capital Gains Tax, Stamp Duty Land Tax and possibly VAT.

Part 3: Wills and Tax Planning

Many couples have Wills incorporating a nil rate band discretionary trust: should they change these now that the transferable nil rate band is available?

Not necessarily, because usually the trust is drafted flexibly so that the assets could be given to the survivor so that the transferable nil rate band of the first spouse to die is preserved.

If this is done the survivor can make lifetime gifts (if circumstances allow) to reduce the IHT in their estate. This may be particularly appropriate if he or she is much younger.

Where there are assets which are likely to grow in capital value very much faster than the uplift in the nil rate band (e.g. land which will be developed) it may be advantageous to still use the nil rate band discretionary trust on the first death depending on the circumstances.

The way forward will depend on the particular circumstances and advice should be taken.

Some circumstances in which trusts should be considered in Wills include the following:

- To preserve assets, perhaps for the children, in the event of the survivor remarrying.

- To reduce the estate of the survivor in the hope of claiming the residence nil rate band on the second death.
- To preserve assets, perhaps for the children of a previous marriage, where there is a second or subsequent marriage.
- To protect part of the assets from being used for long-term care fees.
- To provide a flexible means of passing on assets which qualify for business property relief or agricultural property relief to the next generation.

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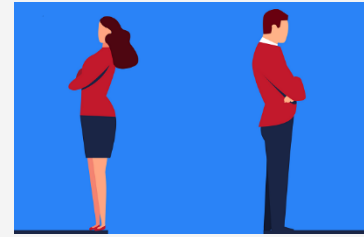
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