MOMENTS THAT MATTER

A guide to inheritance tax planning

hcr harrison clark rickerbys solicitors

Your current and potential future liability to inheritance tax (IHT) is often a significant factor when it comes to your estate planning decisions.

What is inheritance tax and when is it paid?

Inheritance Tax, or IHT as it is commonly known, is payable at a rate of 40%, based on the value of your estate when you die plus any gifts you made during the previous seven years. Your estate is only liable if the total value of the estate (including gifts) is worth more than the IHT threshold of £325,000.

There is also a lifetime rate of IHT (20%) applicable to chargeable transfers of assets made during your lifetime. More information on this can be found later in this guide.

Your estate is not generally liable for IHT if you leave everything to your spouse or civil partner. If an estate is liable for IHT, an initial payment towards the IHT bill must be paid by the end of the sixth month following an individual's death. This can often mean that tax is due before the estate has been settled. There is some flexibility to pay IHT in instalments if there are assets which may take time to sell, although interest is usually added in this case. Careful planning is therefore required so that you are aware of potential liabilities and ways that the liabilities could be reduced.

Is anything exempt from IHT?

There are some gifts and assets which are not counted for IHT purposes. These include:

- The first £3,000 of gifts you make in a tax year
- Gifts of up to £250 to any number of people per tax year
- Regular gifts made from your excess income
- Gifts to children (up to £5,000) and grand and great grandchildren (up to £2,500) for their marriage or civil partnership
- Gifts to your spouse or civil partner (providing they are UK domiciled)
- Gifts to charities, political parties, and specific organisations such as the National Trust or British Museum
- Gifts made more than seven years before your death
- Gifts made more than three years but less than seven years before your death may benefit from a lower rate of IHT.

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What reliefs are there from IHT?

Depending on your specific circumstances, there are also other IHT reliefs that may apply to reduce your IHT liability. These include:

Nil rate band

This applies to all estates meaning that the first £325,000 of your estate is not liable for IHT. If you don't use all of your nil rate band, this can be passed on to your surviving spouse or civil partner. The transfer is the proportion unused by the first spouse and will apply to the band in place when the second spouse dies. If the band has increased in this time, there could be a significant increase in the nil rate band available for the survivor's estate.

Using trusts as part of your inheritance tax planning can help to reduce your IHT liability as well as protecting assets.

Residence nil rate band

To qualify for this relief, you must pass on your main residence (or the proceeds from it), directly to your children or grandchildren when you die. If you don't use all of your residence nil rate band, it can be passed on to your surviving spouse or civil partner.   Using this relief could increase your IHT allowance to £500,000 for an individual and £1,000,000 for a couple. However, the relief is tapered for estates over £2m and therefore not available if your estate is worth more than £2.35m.

Taper relief

For gifts made more than three but less than seven years ago, you may qualify for taper relief, reducing the rate of IHT you would pay on those gifts.

Agricultural property relief

If your estate includes property which is used for agricultural purposes, the property may qualify for relief of 50% or even 100%. There are conditions associated with this and it does not apply to any non-agricultural element such as development value.

Business relief

If you have a business interest, you may also be able to claim business relief at 100% on land, buildings, plant and machinery used in the business. Not all types of business interests are eligible for this relief and there is also a qualifying period for ownership (currently two years).

Reduced rate of IHT for charity donations

If you decide to leave 10% or more of your estate to charity, a reduced rate of IHT (36%) may be applicable to the remainder of your estate.

Some gifts are not counted for IHT purposes including gifts to children on their marriage, gifts to charity and gifts made more than seven years before your death.

Reducing IHT as part of your wider tax planning

IHT advice can be complex and is very much tailored to your individual circumstances and wishes to maximise the use of all possible exemptions and reliefs.

Trusts in your will can also be particularly useful to help reduce IHT in a range of circumstances including:

- If your assets are likely to grow quickly and potentially exceed the nil rate band and any transferable nil rate band
- To increase the possibility that the estate of the survivor can claim residence nil rate band on their death if their estate may otherwise exceed the taper threshold
- To provide a flexible way to pass on assets which qualify for agricultural property or business property relief

They can also have other benefits such as:

- Preserving assets for children from a first marriage or if the survivor should remarry
- Protecting assets from being used for care home fees

You should review whether you are able to make gifts in your lifetime which can significantly reduce your IHT liability if you survive more than seven years. You may also want to consider whether it may be preferable to transfer assets into a trust set up in your lifetime, rather than making outright gifts to individuals. There are, however, IHT charges payable on the creation of a trust, every ten year anniversary and when capital is distributed (although there are exceptions if the trust is being created for a disabled person).

When considering your Will and estate planning, IHT should always be considered at the same time to minimise any IHT liability whilst ensuring that your needs are met, both now and in the future.

For more information about the potential impact of IHT on your own estate, contact a member of the HCR Private Client team.

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