

SUTTON McGRATH HARTLEY

WILLS & PROBATE

Introduction to Inheritance Tax

Keep it in the Family



What is Inheritance Tax (IHT)?

IHT is a tax that can become payable on the value of an Estate when a person dies.

It is also payable on outright gifts made during a person's lifetime and on gifts to a Trust during a person's lifetime (please see Lifetime Gifts for further details).

The tax rate payable on Estates valued in excess of the Nil Rate Band is 40% (subject to relief at a special lower rate where charitable donations are made, please see below).

The majority of Estates do not pay any IHT, because there is no IHT charge on Estates valued at less than the Nil Rate Band.

What is the Nil Rate Band?

In the current tax year the Nil Rate Band is £325,000.

So, for example, if the Estate is valued at £400,000 there is no tax due on the first £325,000, but tax is payable at 40% on the remaining £75,000, resulting in a tax bill of £30,000.

What is the "Residential Nil Rate Band"?

In addition to the Nil Rate Band, from April 2017 an additional main residence nil rate band will be available to cover the value of the deceased's home. Initially the additional nil rate band will be £100,000 per person rising to £175,000 per person by April 2020. The additional band can only be used where the property in question is left to the direct descendants of the deceased and not, for example, to a Trust. There will be tapered withdrawal of the additional nil rate band for Estates with a net value in excess of £2 million.

Spouse exemption

Assets passing to a UK domiciled spouse or civil partner are exempt from IHT. This is known as the 'spouse exemption'.

Since 2007, if the first spouse to die does not use up all their Nil Rate Band (perhaps because they left everything to the surviving spouse), the surviving spouse's Personal Representatives will be able to make a claim for the unused proportion on the second death.

For example: Mr and Mrs Hughes are between them worth £1m. Mr Hughes dies leaving his entire Estate to Mrs Hughes. There is no IHT payable on his death because of the spouse exemption. Mrs Hughes then passes away and leaves her entire Estate to her children.

Mr Hughes did not use any of his Nil Rate Band so it is all available for transfer to Mrs Hughes. Subject to making a claim, and assuming the Nil Rate Band on second death is £325,000, Mrs Hughes will have £650,000 of Nil Rate band to offset against the £1m joint Estate.

The Estate pays no tax on the first £650,000 and 40% on the remaining £350,000, giving a tax bill of £140,000.

Lifetime gifts

Assets gifted during your lifetime have the effect of reducing the value of your Estate for IHT purposes.

In this context, there are 3 categories of lifetime gift:

1) An 'Exempt' gift. These are not subject to Inheritance Tax (please see Exemptions and reliefs in the next section).

2) A 'Potentially Exempt Transfer' (PET). These are 'outright gifts' that are 'potentially' exempt from the charge to IHT.

This means there is never any IHT charge at the time of making a PET (because such gifts are 'potentially' exempt at the time), and there will be no IHT on death provided you survive the gift by 7 years.

If you do not survive a PET by 7 years the gift becomes chargeable to IHT; however, there may still be no tax actually payable, provided your 'cumulative transfers' do not exceed the Nil Rate Band.

3) A 'Chargeable Lifetime Transfer' (CLT) will arise on a gift into Trust.

IHT is only payable at the time of the gift if your 'cumulative transfers' exceed the Nil Rate Band, but even then tax is only payable at half the 'IHT death rates'.

If you do not survive a CLT by 7 years, further IHT will become due.

Taper Relief is available for both PETs or CLTs if you survive more than three years from the date of the gift, and this acts to reduce the rate of tax payable on the lifetime transfer.



Exemptions and reliefs

Spouse Exemption - all outright gifts to spouses/civil partners domiciled in the UK are exempt from IHT, whether made during lifetime or on death. The spouse exemption is limited to £325,000 if the person making the gift is UK domiciled and the recipient is non-domiciled.

Business Property Relief - Relief available can either be at the rate of 100% or 50% depending on the type of business asset held. Business assets such as shares in an unquoted trading company and interests in a business whether carried on as a sole trader or partnership can qualify for 100% relief.

Agricultural Property Relief - Relief is available at the rate of 100% and 50% depending on the agricultural asset held. The relief is available depending on the length of time the asset has been held and its use at the date of death and in the years preceding death.

Charity exemption - all outright gifts to qualifying charities, whether made during your lifetime or on your death, are exempt from IHT.

A gift to charity can also reduce the IHT rate from 40% to 36% on the remainder of your chargeable Estate.

Regular gifts out of surplus income - any regular gifts made out of excess net income are exempt from IHT. These gifts must not affect your normal standard of living; otherwise the Revenue will deny the claim for this relief.

Annual Exemption - an individual can give away up to £3,000 each tax year. If not used or fully used in one tax year, the unused part may be carried forward for one tax year.

Small Gift Exemption - you can make gifts of £250 to any one individual each tax year. The number of individuals is unlimited.

Wedding and Civil Partnership Gifts - a parent may give £5,000, a grandparent £2,500, anyone else may give £1,000 free of IHT.

Who is responsible for paying IHT?

This depends on the circumstances.

The Personal Representatives are primarily responsible for tax on the Deceased's Estate, but the trustees of any Trust established by the Will and the recipients of any lifetime gifts that become chargeable may also be liable for payment of tax.

Summary

The purpose of this factsheet is to provide a basic overview of the current inheritance tax legislation. As you may have noticed the rules are complex and any programme of tax planning should be conducted with the aid of a professional.

Sutton McGrath Hartley offers a NO OBLIGATION INITIAL CONSULTATION to review your requirements. Following this, should you wish to proceed, our fees to prepare a personalised report on suggested strategies for inheritance tax mitigation start from **£750 + VAT**. The cost for then implementing any of those recommendations would be calculated on a time charged basis and would be agreed with you prior to the commencement of work.

To speak to a specialist adviser today simply call us on 0114 266 4432 or email: wills@suttonmcgrathhartley.co.uk



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SUTTON M_CGRATH HARTLEY



Sheffield Office
0114 2664432

Chesterfield Office
01246 277266

Rotherham Office
01709 872106

Email: wills@suttonmcgrathhartley.co.uk

www.suttonmcgrathhartley.co.uk