Inheritance Tax (IHT)

What is it?

IHT is a charge on a person's capital wealth. It can be charged as a lifetime tax on capital but it is usually paid when someone dies. Not everyone pays it. There are allowances and exemptions.

IHT was once known as the voluntary tax. There are still ways to mitigate IHT both upon death and during a person's lifetime.

The Inheritance Tax threshold

This is referred to as the nil rate band or the individual exemption to Inheritance Tax. The current nil rate band is £325,000 and the pre-Budget Report indicated that this threshold will remain until 2018. The new Tory Government pledged changes but these are yet to be implemented.

Residential Nil Rate Band

An extra allowance may also be available known as the residential nil rate band. This is currently set at £100,000 and will rise in £25,000 increments to £175,000 by the tax year 2020-2021. Certain criteria needs to be satisfied for your estate to be eligible. You must own (or have owned) a property in which you reside and that property must be left to your direct issue absolutely. In order to establish whether your estate would be eligible we would recommend reviewing your Wills and taking legal advice as the criteria and rules are complex.

Exempt beneficiaries

Gifts to the following people and organisations are exempt:-

1. Your husband, wife or Civil Partner as long as they have a permanent home in the UK;
2. UK charities;
3. Some national institutions such as museums, universities and the National Trust; and
4. Any UK political party that has at least 2 members elected to the House of Commons or has one elected member but the party received at least 150,000 votes.

NB. Gifts that you give to an unmarried partner or a partner that you are not in a registered Civil Partnership with are not exempt.

Annual exemption

Gifts worth up to £3,000 in each tax year will be exempt from IHT when you die. You can carry forward any unused part of the £3,000 exemption to the following year but if you don't use it in that year the carried forward exemption expires. The annual exemption is in addition to other gift exemptions.

Exempt gifts

Wedding gifts/Civil Partnership ceremony gifts

- Parents can each give cash or gifts worth £5,000
- Grandparents and great grandparents can each give cash or gifts worth £2,500
- Anyone else can give cash or gifts worth £1,000

Note the gift has to be made before the wedding or Civil Partnership ceremony. It can consist of a promise to make it. If the ceremony is called off and you still make the gift or if you make the gift after the ceremony without having promised it first the exemption will not apply.

Small gifts

You can make small gifts up to the value of £250 (out of capital) to as many people as you like in any one tax year. However, you can't give a larger sum claiming exemption for the first £250. In addition you can't use your small gifts' allowance with any other exemption when gifting to the same person.

Regular gifts or payments that are part of your normal expenditure

Regular gifts you make out of your after tax income are exempt from Inheritance Tax. These gifts only qualify if you have enough income left after making them to maintain your normal lifestyle.
These include:-

- Monthly or regular payments to a person
- Regular gifts for Christmas or birthdays or wedding/Civil Partnership anniversaries
- Regular premiums on a life insurance policy for you or someone else

You can also make exempt maintenance payments to :-

- Your husband, wife or Civil Partner;
- Your ex spouse or former Civil Partner;
- Relatives who are dependent on you because of old age or infirmity; and
- Your children who are under 18 or in full time education.

The 7 year rule – potentially exempt transfers (PETs)

Any gifts you make to individuals will be exempt from Inheritance Tax as long as you live for 7 years after making the gift. These sorts of gifts are known as 'Potentially Exempt Transfers'.

However, if you give an asset away at any time but keep an interest in it eg. give your house away but continue to live in it rent free the gift will not be a Potentially Exempt Transfer and will fall back into your estate. This is known as a gift with reservation of benefit and should be avoided.

If you die within 7 years and the total value of the gifts you made is less than the nil rate band then the value of the gift is added to your estate and any tax due is paid out of the estate.

If you die within 7 years of making the gift and the gift is valued at more than the Inheritance Tax threshold Inheritance Tax will need to be paid on its value either by the person receiving the gift or by the estate.

A relief known as Taper Relief will apply if you die between 3 and 7 years after making the gift. Inheritance Tax is reduced on a sliding scale known as Taper Relief. Taper Relief is applied against the rate of tax.

Taper Relief reductions

Time Between the date the gift was made and the date of death	*Taper Relief % applied to the tax due*
3-4 years	20%
4-5 years	40%
5-6 years	60%
6-7 years	80%

Example of Taper Relief

Jane made a gift of £350,000 on 15th January 2006. She died on 15th April 2009. The Inheritance Tax threshold in that year is £325,000.

To work out the Inheritance Tax due:-

1. Take away the threshold from the value of the gift; £350,000 - £325,000 = £25,000. Inheritance Tax is due on £25,000
2. Work out the Inheritance Tax at the full rate of 40%. The figure payable is £10,000.
3. The gift was made within 3-4 years of death. Taper Relief at 20% is allowed; £10,000 x 20% = £2,000.
4. Take away the Taper Relief for the full tax charge; £10,000 - £2,000 is £8,000.

In the above example Taper Relief reduces the tax payable from £10,000 to £8,000.

Gifts into trusts

Gifts into trusts are not generally exempt from Inheritance Tax. If a trust is for a disabled person the transfer into trust counts as a Potentially Exempt Transfer it will be exempt from Inheritance Tax if you survive 7 years after making the gift.

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The importance of keeping records

It is very important that proper records are kept to assist your executor or personal representative to sort out your financial affairs when you die. Keep a record of any gifts you make and note on that record which exemption you are using.

Also keep a record of your after tax income if you make regular gifts out of income as part of your normal expenditure. This will show that the gifts are regular and that you have enough income to cover them and your usual day to day expenditure without having to draw on your capital.

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March 2018