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# Inheritance Tax Planning

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## What is Inheritance Tax (IHT)?

In its most basic terms, it is a tax charged on what you own when you die. The current rate of IHT is 40%.

Death and tax are often described as the only two certainties in life, and IHT means they can turn up at the same time.

There are ways to reduce or remove IHT altogether, and the sooner you act the better placed you will be to pass on more to your loved ones.

## Will I be affected by IHT?

There is normally no IHT to pay if either:

- the value of your estate is below the £325,000 nil rate band (NRB) threshold; or
- you leave everything above the £325,000 threshold to your spouse/civil partner or a charity, although the threshold may be reduced if you have made gifts within the 7 years before your death.

To work out whether you will be affected you need to work out the value of the assets that you own, not including any pensions. For IHT purposes, practically everything you own is relevant and has to be taken into account and reported to HMRC, even if it can then be removed from the calculation of the amount of tax due.

## What needs to be included?

Your gross taxable estate includes:

- all assets owned in your sole name;
- the value of your share of any jointly owned property;
- the value of any trust from which you receive income;
- any gifts made by you in the 7 years prior to death.

## What can be deducted?

The main deductions are:

- Debts (credit card bills, funeral costs, loans)
- Reliefs (Agricultural Property Relief, Business Property Relief)
- Exemptions (spouse/civil partner, charity)
- The tax-free NRB

## Transferrable NRB

If you are married or in a civil partnership and your spouse/civil partner will inherit all of your assets on your death, your NRB will be transferred to them, increasing their NRB threshold to £650,000. Similarly, if you have been widowed you may be able to claim the IHT threshold which was unused by your late spouse.

### Residence NRB

You may also qualify for the residential nil rate band (RNRB) if you give away your home to your children (including adopted, foster or stepchildren) or grandchildren. The RNRB is currently £175,000. This is also transferrable to your spouse/civil partner, and could potentially increase their threshold to £1 million.

If you leave at least 10% of your net estate to charity you may qualify to pay IHT at the reduced rate of 36%.

HMRC have an online Inheritance Tax Checker which will give you an approximate value of the estate and help you to decide whether any IHT is likely to be payable. Please note the checker does NOT calculate the amount of IHT that is owed. Go to https://www.gov.uk/valuing-estate-of-someone-who-died/estimate-estate-value#use-the-online-inheritance-tax-checker

### How to calculate your IHT liability

| Your Asset | Value |
|---|---|
| Your home (after deduction of any mortgage) | £ |
| Any other property (after deduction of any mortgage) | £ |
| Cash | £ |
| Investments | £ |
| Possessions | £ |
| Life insurance (where not in trust) | £ |
| Trust investments of which you are a life tenant, established following the death of another person | £ |
| **Total assets** | **£** |
| (minus 100% of the property value up to £175,000 or potentially up to £350,000 if you have been widowed)* | £ |
| (minus £325,000)** | £ |
| **Total exposed to IHT** | **£** |

* the value of the main RNRB threshold is only applicable if your main residence is given to a direct descendant and will be reduced or taken away completely if your total estate is valued above £2 million on your death.
** add any additional nil rate band inherited from a late spouse. The figure may be less than £325,000 if you have made any substantial gifts in the 7 years before your death.

Please note tax rules are subject to change and benefits depend on personal circumstances. The exact amount of tax payable will depend on your individual circumstances.

## Ways to reduce IHT

IHT can be reduced by spending, gifting and investing.

**1. Spending**
Spending your money on things such as holidays and eating out will immediately reduce the value of your estate and the amount of IHT you need to pay, although this is unlikely to have a major impact unless your lifestyle changes dramatically. If you buy expensive items such as cars or artwork these may be classed as investments, and will stay in your estate.

**2. Gifting**
Gifting to your loved ones with money towards house deposits or university fees can reduce the size of your estate and give them a helping hand. There are 3 main types of gift – exempt gifts, potentially exempt gifts and chargeable gifts.

- Exempt gifts are IHT free immediately
- Potentially exempt gifts become IHT free over time
- Chargeable gifts might result in an immediate IHT charge

There are, however, rules to be followed and you should bear in mind that once you make a gift you cannot take it back and will no longer benefit from any income or capital gain on it.

**2.1 Exempt gifts** are free of IHT and can be made in several ways:
*Marriage* – married couples can transfer any assets between themselves during their lifetime or on death.
*Annual exemption* – each tax year you can gift up to £3,000 to anybody you like. You can also gift any unused allowance from the previous year.
*Small gifts* – you can gift anyone up to £250 each tax year, provided you have not already gift any other gifts to the same person during the same year.
*From extra income* – if you have extra income after tax that you do not need, you can make regular gifts. You will need to keep a record of these – use form IHT403.
*For a wedding* – you can give your children up to £5,000 and grandchildren or great-grandchildren up to £2,500 when they get married. You can give anyone else up to £1,000.
*To charities or political parties* – any donations to these types of organisation, either during your lifetime or in your will, are IHT free. This includes property, shares and land. If you leave at least 10% of your net estate to charity in your will the rate of IHT reduces to 36%.

**2.2 Potentially exempt gifts** are outright gifts that do not fall within one of the previous exemptions and are usually IHT free if you live for 7 years after making the gift. There is usually no limit to the value of these gifts. If you do not live for 7 years after making the gift, the portion exceeding the £325,000 threshold will be taxed and the tax due is calculated on a sliding scale, known as taper relief, based on the time between the gift and death. The total amount of potentially exempt gifts in the 7 years before death which falls within the value of the tax-free threshold will reduce it accordingly, so more of your assets will become taxable.

**2.3 Chargeable gifts** are those that do not fall into any of the above categories, and may be charged to IHT immediately. A charge is usually made if the total value of gifts made in a 7 year period exceeds the £325,000 threshold. Gifts to a discretionary trust are the most common example.

**3. Investing**

Some investments offer IHT savings, but can be higher risk.

**3.1 Business Relief** – certain companies qualify for 100% relief from IHT, meaning there is no IHT to pay. You must have held shares for at least 2 years and they can be held until death without triggering a liability. You can pass on a family company, business, unquoted shares or AIM-listed shares on your death without being subject to an IHT charge. There is no limit on the amount you can transfer.

**3.2 Investing for Children** – helping your children and grandchildren can be part of your IHT plan.
*Junior ISAs* – you can add up to £9,000 per year and the child can access the money from their 18th birthday.
*Junior pensions* – you can add up to £2,880 per year and receive 20% tax relief from the government, giving a total of £3,600 free of tax. The child can only access the money from age 55 (57 from 2028 or later as pension rules change).
*Bare trusts* – you can make a gift into an investment account to create a simple trust. Beneficiaries are nominated on creation and cannot be changed, and can benefit at age 18. Most commonly used where amounts are smaller.

**3.3 Trusts** – can be used to save tax and control assets. Bare trusts (see above) and discretionary trusts are the most common choice, but you could also choose discounted gift trusts and loan trusts.
*Discretionary trusts* – the trustees control the money, beneficiaries can be changed as your family changes and the money is usually protected from divorce or bankruptcy.
*Discounted gift trusts* – provide immediate IHT savings and a regular income. A gift is made into the trust and is split in 2 parts. The first part is treated as a gift and will fall out of the estate after 7 years. The second part (the discount) provides income to the investor for life and is immediately IHT free.
*Loan trusts* – slow down the growth of the estate value and the amount of IHT. Money is loaned to a trust, which is invested. Full or partial repayment can be made at any time. The outstanding amount is always in your estate but

growth is IHT free.  The loan is set up interest free and regular repayments can be made to provide an income stream.

**3.4 Pensions** – fall outside of your estate, you can name as many beneficiaries as you want and there is no IHT for them to pay.  If you die before you are 75 and your pensions are below the lifetime allowance, currently set at £1,073,100, your beneficiaries can withdraw what they want to without paying tax.  If you die age 75 or older withdrawals will be taxed as the beneficiary's income.

Please remember that tax rules and benefits constantly change.  You should review your gifting every year as there are various annual exemptions which can be used.  Investment based plans should also be reviewed annually.

**Useful Links**

https://www.gov.uk/inheritance-tax

https://www.gov.uk/valuing-estate-of-someone-who-died/estimate-estate-value#use-the-online-inheritance-tax-checker

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