

Inheritance Tax (IHT)

Updated September 2013

To prevent people from avoiding inheritance tax by giving all their money and assets away before they die, HMRC charges IHT.

IHT is primarily viewed as a tax charged on a person's death estate but in reality IHT is tax charged on transfers of capital by individual's pre death and on the value of their estate post death.

UK domiciled individuals are chargeable to IHT in respect of property held anywhere in the world. Non-UK domiciled individuals are chargeable to IHT in respect of property held solely in the UK. More information regarding whether someone qualifies as domiciled in the UK is given later in this article.

As well as IHT being due on capital transfers made during their lifetime IHT is also paid on the value of someone's estate (i.e. all the assets less liabilities that they owned etc.) when they die. IHT is only payable on any portion of that estate that exceeds a threshold of £325,000, and is chargeable at 40%. (The IHT threshold has been frozen until 2018). Basically any IHT due is paid out of the net estate of the deceased with the beneficiaries getting their share of the net estate after tax.

When property is gifted a capital gain may also arise and capital gains tax (CGT) may be charged on the deemed value of the transfer (there are some exceptions here, like shares in an unquoted trading company). However, cash given away is not subject to CGT, but it may be subject to IHT. There are a number of exceptions that enable gifts of money to be given, without tax being liable. Those exceptions break down according to who the money is given to, why it is given, the amount you give and how long you live after giving money away as a gift.

Exempt Transfers

You can give as much money as you like to certain people and organisations without paying IHT (this applies whether you give money whilst living or after your death, via your will). Exempt beneficiaries include your spouse or civil partner, (provided they live permanently in the UK), Charities registered in the UK, some national organisations, e.g. certain museums.

You are allowed to give away a total of £3,000 each year (annual exemption), without any tax implications. Your Annual Exemption can be carried forward for one year only if it has not been used. If you did not make any gifts of money during the last year, you can therefore give away a total of £6,000 in the current year. Equally, if you gave away £2,200 last year, you'll be able to give away a total of £3,800 this year.

In addition to the annual exemption above, you can give away small gifts – not more than £250 – to as many people as you like in one tax year. However, the total gifts to a single person must not exceed £250 in that tax year therefore you could give away 10 lots of £250 tax free to 10 different people but you couldn't give 10 lots of £250 tax free to the same person as it is the value of the total gifts made in the year that counts.

You can also make tax free gifts in consideration of marriage and/or civil partnerships provided that you give, or promise to give, a cash gift on or shortly before the ceremony without being liable for Inheritance Tax. The limits on such gifts depend on your relationship with the recipient. Parents can gift £5,000 tax free, grandparents can gift £2,500 tax free and anyone else can give up to £1,000.

Any gifts that are part of your normal expenditure are exempt – provided they are made from your after tax income (not your savings) and that you have enough money left over to maintain your usual standard of living.

The above are the main examples of exempt transfers that can be made but it is not exhaustive and there are other transfers that can be exempt. Before making a transfer of capital it is always worth getting advice to see whether this transfer has an IHT implication.

Potentially Exempt Transfers (PET)

If a person makes a gift that qualifies as a PET and the donor survives seven years after making the gift then no IHT is due on the gift and it is exempt from IHT.

In addition if the donor dies within three to seven years after making the PET then IHT may be due but at a reduced rate – this is known as ‘Taper Relief’.

Common examples of PET’s are gifts of cash and property.

Chargeable Lifetime Transfers (CLT)

The value of a CLT is the difference between the value of the donor’s estate before and after the transfer, reduced by any available exemptions. The annual exemption and the NIL rate threshold of £325,000 are available providing they have not already been used against earlier chargeable transfers.

The main category of transfers that are CLT’s are gifts into lifetime trusts (except disabled trusts).

The IHT due on a CLT is usually paid by the recipient, but it can be paid by the donor if an election is made.

The lifetime rate for IHT is 20%.

Transfers on death

On an individual’s death they are treated as making a final transfer of the whole of their estate. The IHT due is dependent upon the value of the estate, ignoring ‘excluded’ property, and any PET’s or CLT’s made within the previous seven years.

There are numerous things to consider when making a transfer and we would recommend that professional is always obtained but a couple of other considerations that frequently affect people when it comes to IHT planning are as follows:

Gifts with reservation of benefit (GRB)

Property that is gifted may still be treated as belonging to the donor, and therefore will form part of the estate on death, if the donor continues to enjoy any benefit from it. A common example of this is when parents gift their homes to their children but continue to reside in the property rent free.

This is actually a complex aspect of IHT and detailed guidance should be followed if a transfer is made and there is a potentially a GRB implication.

Pre-owned assets

Provisions have been introduced to impose an income tax charge where the taxpayer has the benefit of free or low cost use of an asset that they have previously owned. These provisions apply to land, chattels and gifts into trusts of intangible assets (including cash).

There are also a number of reliefs available to either reduce the amount chargeable to IHT, or to reduce the amount of IHT due, these are detailed below:

Business Property Relief (BPR)

BPR is available on the transfer of business property providing certain conditions are satisfied. Relief ranges from 100% relief on the transfers to 50% relief.

Agricultural Property Relief (APR)

APR is available on the transfer of agricultural property providing certain conditions are satisfied. Again relief ranges from 100% relief on the transfers to 50% relief.

Use of Insurance

There are occasions whereby the potential IHT liability at the time a transfer is made will not be known, most notably when PET's and CLT's are made. Insurance can therefore be taken out by the donee to provide for the possible tax liability.

Domicile

Domicile is the country you consider to be your home even if you are resident in the UK. Some people define it as the place you wish to be buried. HMRC can deem a person to be domiciled in the UK, this is the concept of 'deemed domicile'. This means even if you are not domiciled in the UK under general law we will treat you as domiciled in the UK at the time of a transfer if you were domiciled in the UK within the three years immediately before the transfer, or you were resident in the UK in at least 17 of the 20 income tax years of assessment ending with the year in which you make a transfer.

If there is taxation from an overseas country on UK situated assets, then either the double taxation agreement with that country should over ride the tax position, so only tax is being paid in one country. If there is no double taxation agreement, then "unilateral relief" can be claimed, which means getting a credit for the foreign tax. This is generally allowed provided the taxation is of a similar character to the UK.

Transfer of IHT Allowances

Since October 2007, you can transfer any unused Inheritance Tax threshold from a late spouse or civil partner to the second spouse or civil partner when they die. This can increase the Inheritance Tax threshold of the second partner - from £325,000 to as much as £650,000 in 2013-14, depending on the circumstances.

Gifts to Trusts and Companies/EBT's

For most types of Trusts IHT is due when you make transfers that total more than the Inheritance Tax threshold (£325,000 in 2013-14 tax year). You work this out by adding up the value of any transfers (based on the loss in value to the settlor's estate) and any chargeable gifts made in the previous seven years by the settlor. Inheritance Tax is due on everything above the threshold. The "settlor" is the person setting up the Trust.

If the trustees pay, the rate of tax is 20 per cent. If the settlor pays the IHT instead of the trustee, this means there will be an increased loss from the settlor's estate. The amount of tax due will therefore increase. These calculations are complex.

Specific advice should be taken if it is proposed to set up and/or transfer assets into a Trust or Company.

Any alteration in the structure of the shares of a company, resulting in a reduced value in a person's estate, may result in a lifetime transfer and be subject to IHT.

Payments into employee benefit trusts may give rise to IHT liabilities are participators in close companies participate.

Please Note/Disclaimer

Please note that this is just a brief outline of the IHT regime as it is so extensive. We would recommend that professional advice should always be taken before transfers or any planning. No reliance should be placed on this information, without taking professional advice, relevant to actual facts and circumstances. If the value of your estate exceeds, or is close to, the current IHT threshold of £325,000 then IHT planning and advice should be undertaken.

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