PARTNERS WEALTH MANAGEMENT

AN INTRODUCTION TO

Inheritance Tax

Helping you, your parents and your children plan their estates

IHT PLANNING TODAY

THE NIL-RATE BAND

THE RESIDENCE NIL-RATE BAND

LARGER ESTATES

GIFTS & EXEMPTIONS

Inheritance Tax (IHT) has come under the spotlight over the last few years. In the 2022-23 tax year, His Majesty's Revenue & Customs (HMRC) raised £7.1bn in IHT. This figure has doubled in less than a decade since 2011-22.[1]

IHT becomes payable when an individual dies. The amount of IHT due is based on the value of the estate at death and the value of any gifts made in the seven years before. IHT should always form part of your financial planning. Although the impact of this tax is not felt until death, it has the potential to cost an estate many thousands of pounds. Too many clients allow this topic to fall down their 'to-do' list, inertia has led to IHT frequently being referred to as a voluntary tax.

Please take the time to read the key points on this topic below, which includes some solutions to mitigate any potential tax. These could make the difference to your planning, enabling you to pass more of your assets to your family as you had intended.

How much is IHT?

If the estate is liable for IHT, it is usually payable at 40%. IHT is payable on money, savings or any other assets you pass on when you die, and potentially on some gifts you make during your lifetime. This drops to 36% if you give away at least 10% of your estate to charity.

The amount payable is calculated after debts and funeral expenses have been deducted. When someone dies the distribution of their estate will fall either to their executors if they have made a Will, or to administrators if they die intestate. The executors are responsible for paying the tax, which can only come from the deceased person's estate with the prior agreement of HMRC. Once the tax has been paid, the Grant of Probate can be made, allowing the assets or their proceeds to be distributed to the beneficiaries.

The nil-rate band

The nil-rate band (NRB) is the amount up to which no IHT is payable on an estate. The current threshold is £325,000 and this is frozen until April 2028. The transferable NRB was introduced in October 2007. As a consequence of this, any unused portion of an individual's NRB can be passed to the surviving spouse or civil partner on death, hence the survivor's total allowance could be the full £650,000.

The residence nil-rate band

The residence nil-rate band (RNRB) is an additional amount of NRB available for deaths since 6 April 2017, it can provide extra protection from IHT for families looking to pass the family home to future generations. This NRB applies if you want to pass your main residence to a direct descendant such as a child or grandchild (including step, adopted or foster children). It's important to note that only direct descendants can benefit.

The allowance has been introduced in stages over four years, with the final figure of £175,000 per person being reached in tax year 2020-21. This has also been frozen until April 2028.

From that point on, this means that each parent will be able to leave £500,000 in assets that include a 'family home' component of at least £175,000. As the allowance can be passed from one partner to another on death, when the first partner dies their allowance can be transferred to the surviving partner, meaning that they will then have an allowance of £1m.

Larger estates

Where an estate is worth over £2m, the RNRB (but not the individual allowance of £325,000) reduces by £1 for every £2 of value above £2m. This tapering of the relief has the potential to reduce the RNRB to zero. However, as gifts are not included in the calculation this does present us with a planning opportunity.

Gifts & exemptions

Gifting is one of the most straightforward forms of estate planning and can be for a specific purpose such as school fees, or a more general passing on of savings. Gifts can have different IHT treatments depending on the value of the gift, when it was made and who it was given to.

The use of the **annual exemption** means that up to £3,000 can be gifted to more than one individual each tax year without any tax to pay. If all of this allowance isn't used in the previous tax year, then

the unused allowance can be carried forward to the next tax year although it can't be carried forward more than one tax year.

The **small gifts** exemption allows for a gift of up to £250 to be made to more than one individual in any one tax year without being subject to tax. It is important to note that this exemption cannot be combined with the annual exemption and if the gift is greater than £250, the exemption cannot be used for that gift.

Another exemption is that of **normal expenditure out of income**. This allows an individual to make gifts, reducing their taxable estate, so long as three conditions are met:

1. that the gift forms part of the individual's normal expenditure;
2. that it is made from income; and
3. that it doesn't cause a reduction in their standard of living.

If all these conditions are satisfied, then there is no limit to the amount that can be gifted and immediately exempt from IHT. So, for example, grandparents with generous final salary pensions in excess of their needs could contribute to nursery or school fees for their grandchildren.

In the event of a wedding or civil partnership it is also possible to gift exempt amounts. Each parent of a bride or groom can give up to £5,000; each grandparent can give up to £2,500 and any well-wisher can give £1,000.

When it comes to gifting larger amounts, it is important to remember that any gifts made that are not immediately tax-free are considered **potentially exempt transfers**. For these gifts not to be counted as part of your estate on your death, you must outlive the gift by seven years. If you die within the period and the gift is worth more than the nil-rate band, there is taper relief which will apply, so that the tax would be less the later during the seven year period that death occurs.

Where larger gifts are attractive, we would always advise clients to be wary though of falling into the *"gift with reservation"* trap. It is not uncommon for us to hear of individuals *"giving their home away"* to their children but remaining in residence. Such a strategy will not work unless an arrangement to pay a commercial rent is made. Whether a property or any other asset, the gift must be outright, and the person making the gift must no longer be able benefit from it, or there will be no benefit for IHT.

Gifting an asset such as money or property can be complex and you should take specialist advice in the case of a very large estate.

Domicile and Residency

Currently, your liability to UK IHT depends on your domicile at the time of death and not your residency. Therefore, if you are domiciled in the UK, IHT applies to your assets wherever in the world they are situated. In the Spring Budget 2024, the Chancellor announced that residency, rather than domicile, will determine whether non-UK assets are subject to UK IHT from 6 April 2025.

The proposed changes highlight a required ten year presence for global assets to be included for UK IHT and a ten year break from the UK to stop being liable for the tax. However, these proposals could still be amended.

Domicile and residency are complex areas of law and so advice is recommended.

[1] https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary

* We're here to help

Taking expert advice can significantly reduce the amount of tax your estate will need to pay, meaning more of your wealth is passed to your beneficiaries. There are many steps you can take now to reduce the amount of IHT due. If you have queries or would like to discuss any aspect of Inheritance Tax or estate planning, please don't hesitate to get in touch with us on:

- **020 7444 4030**
- **info@partnerswealthmanagement.co.uk**

Top Tips

Make a gift every year

Maximise the use of the exemptions and allowances mentioned above; doing so consistently can reduce the ultimate tax liability significantly.

We recommend keeping a record of how much you have gifted, to whom and when it was made, this will help your executors to claim your exemptions.

Use a trust to cut your IHT

Cash, investments or property can be put into a trust (from which neither you, your spouse nor children aged under 18 can benefit) and they will no longer form part of your estate for IHT purposes. So, for example, putting money into a trust to pay for your grandchildren's education or to provide support for a relative ensures that these are provided for after your death. The situation with trusts is complex and advice should be taken from an estate planning specialist.

Take out life assurance

Whilst a suitable life policy will not reduce the amount of IHT that will be due on your estate, the payment from the policy could both match the amount of tax due and make it easier for your beneficiaries to pay the bill. You would need to have the policy written under trust to ensure that it doesn't form part of your estate on your death. Furthermore, by satisfying the normal expenditure out of income exemption, the premiums will not count as a gift.

Leave something to charity

You can reduce the rate at which IHT is payable by leaving at least 10% of your estate to charity. This would mean that the rate of tax payable on the balance of the estate could be reduced from 40% to 36%.

Claiming Business Relief

Business Relief reduces the value of a business or its assets when working out how much IHT is due. Relief of up to 100% is available. It is possible to get this relief if the deceased owned the business or assets for at least two years before the time of death.

Investments or assets that qualify for Business Relief are not restricted to privately owned businesses, but include unquoted shares listed on the Alternative Investment Market (AIM) of the London Stock Exchange and businesses that private individuals can invest in. Regardless of the two-year ownership period, the individual retains ownership and can choose to sell for their own benefit, should need arise.

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