

A brief guide to Inheritance Tax

Inheritance tax (IHT) is charged on the assets that you own at the time of your death. It follows that the most straightforward way of reducing IHT on death is to give away assets before you die, thus reducing the size of your death estate subject to the tax.

Gifts made in the 7 years before your death are also potentially subject to IHT, although tapering relief can reduce the tax charge, depending on the size of the gift and the survivorship period.

Reliefs at death

Spouse exemption	Any assets that you leave to your spouse or civil partner are exempt from IHT. A large number of wills provide for everything to pass to a surviving spouse or civil partner, and under these circumstances, there should not be any IHT due on the first death.
Nil rate band	Currently, the first £325,000 of your death estate is taxed at 0%, and so no IHT is payable on this first 'slice'. Any element of the band not used on death is transferred to your surviving spouse/civil partner, increasing their Nil Rate Band on death.
Main Residence Nil Rate Band	From April 2017, an additional nil rate band may be available, where a residence passes on death to a direct descendant. This nil rate band is phased in over 4 years, rising from £100,000 in April 2017 to £175,000 by 2020.
Business/agricultural relief	If you own business or agricultural assets, reliefs are available to reduce their value for IHT purposes, typically by 50% or 100%, depending on the assets and the length of ownership. AIM shares can also qualify as a business asset, provided a minimum ownership period is satisfied.

Lifetime reliefs

A variety of reliefs exist for gifts made during your lifetime:

Annual exemption	An annual exemption is available to individuals, exempting the first £3,000 of any gifts made in each tax year. Any unused element of the exemption can be carried forward for one year.
Small gifts exemption	Each year, any gifts of up to £250 to an individual are exempt from IHT. This exemption applies to any number of gifts to different individuals (so for example, gifts of £250 to each of your grandchildren would each be exempt).
Wedding/civil partnership gifts	This relief ranges from £5,000 for a gift to your child, £2,500 for a grandchild or £1,000 for anybody else.
Regular Gifts from Income	Any gifts that you regularly make from your surplus net income are exempt from IHT. For this exemption to apply, an individual will need to demonstrate that the gift is from their net income, does not diminish their standard of living, and should establish a regular pattern of such gifts.

Charitable Gifts

Gifts to charity (both during your lifetime, and from your death estate) are exempt from IHT. Your estate can also benefit from a lower (36%) rate of IHT if over 10% of the net estate is left to charity.

Lifetime gifts

Before making lifetime gifts, it is important to consider their potential impact. The main points to consider include:

- Do I need the income that the asset produces?
- Do I want to retain some control over the asset?
- Am I happy that the asset is passing into safe hands?

To retain some control, or protect assets, a common planning measure is to make the gift via a trust, where the trustees oversee the trust's assets and decide on distributing any income arising. Please see our separate guide on trusts for more information.

Gifting an asset whilst continuing to benefit from it (e.g. gifting your home whilst continuing to live there) will ordinarily result in the asset still being included in your death estate. There are schemes available that can overcome this problem, however careful attention needs to be paid (as well as professional fees) to the set-up of such schemes, as HMRC will usually scrutinise these in detail.

The timing and method of gifts will depend on your assets. If you have reasonably liquid assets (e.g. cash, quoted stocks and shares), then you have more flexibility to make gifts at a time of your choosing, and can do this in a gradual process, smoothing any impact on your income. Whilst gifts of non-cash assets will usually have capital gains tax (CGT) consequences, the spreading of gifts over a period of years to maximise CGT allowances and exemptions should wholly or partially reduce any CGT exposure.

As returns on cash deposits have fallen in recent years, it is becoming increasingly common for individuals to invest in less liquid assets (typically property) to generate an income. This can make gifts more difficult to structure, as well as offering less CGT flexibility. Again, with careful planning, these problems can be overcome, although administrative costs are likely to be incurred.

Find out more

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