



## Inheritance Tax – An introduction

### A brief history

The introduction of a tax on estates in England and Wales in 1796 was the precursor of the inheritance tax system we have today. The current system of inheritance tax was first introduced in 1986. Inheritance tax counts for less than 1% of government income.

### What is Inheritance Tax?

Inheritance tax is levied on a person's estate when they die and can also be payable during a person's lifetime on certain trusts and gifts. The rate of inheritance tax payable is 40% on death and 20% on lifetime gifts. There is a nil rate band, currently £325,000 below which no inheritance tax is payable. There are also a number of reliefs which are covered later in this guide.

It is important to note that, other than in the case of very large gifts (above the nil rate band) no inheritance tax is payable on gifts made or received during someone's lifetime. However on death the executors are required to report on the value of taxable gifts made by the deceased during the seven year period immediately prior to their death.

In the March 2011 Budget, the Chancellor announced his intention to introduce a reduced rate of inheritance tax of 36% from April 2012 where 10% or more of a net estate is left to charity.

### Inheritance Tax Rates

	2010-11 (£)	2011-12 (£)
Nil rate band for individuals*	£325,000	£325,000
Thereafter - lifetime gifts **	20%	20%
- on death	40%	40%

\* Unused nil rate band can be used by surviving spouse or civil partner

\*\* Increased to 40%, subject to tapering relief, on gifts made between 3 and 7 years pre death. Certain lifetime gifts are exempt. There are special rules for business property.

Years before death	0-3	3-4	4-5	5-6	6-7
% of death charge	100%	80%	60%	40%	20%

### Main exempt lifetime gifts

Recurring annual gifts out of surplus income	unlimited
Annual gifts out of capital (with one year carry forward if unused)	£3,000
Small gifts (per recipient)	£250
Parental gift on marriage	£5,000
Grandparent or party to marriage	£2,500
Other gifts on marriage (per donor)	£1,000



## **Inheritance Tax and probate forms**

It is a legal requirement to complete inheritance tax forms as part of the probate process even where no inheritance tax is due. The estate must pay some or all of any inheritance tax due before a grant of probate can be obtained.

## **Valuing an estate**

In order to ascertain whether or not inheritance tax is due the executor or personal representative of the deceased must value the deceased's estate. This is done by calculating the total value of the assets and gifts of the deceased and deducting any debts.

## **Payment of inheritance tax**

Inheritance tax is due six months after the end of the month in which the deceased died. In certain cases it is possible to pay by annual instalments or to make payments later with the addition of interest.

## **Transferable nil rate band**

In October 2007, important changes were made to the workings of inheritance tax which benefitted married couples and civil partnerships. It became possible for a surviving spouse or civil partner to receive the benefit of the nil rate band unused on the death of their partner. When the second person dies, their estate is allowed to utilise their own nil rate band plus the remaining proportion of the unused nil rate band from the death of the first partner.

This in effect allows for the doubling of the nil rate band for married couples and civil partners and is effective where the second death occurs after 9 October 2007. The changes were widely welcomed when they were announced and removed the need for a large number of trusts which had been put in place to try and achieve a similar outcome.

## **Reliefs and exemptions from inheritance tax**

### Donations

Any gifts made to a UK charity during a donor's lifetime or in his will are exempt from inheritance tax. Political donations to any UK political party that has at least two members elected to the House of Commons or has one elected member but the party received at least 150,000 votes are also eligible for relief. It is also possible to make donations to certain national institutions such as museums, universities and the National Trust and benefit from relief.

### Business Relief

Business relief (50% or 100%) can be claimed on qualifying property and buildings, or assets such as unlisted shares or machinery.



### Agricultural property

Agricultural property relief (50% or 100%) can be claimed on farming land, working farmhouses, farm workers' cottages and barns. There is no agricultural relief for farm equipment but the equipment may qualify for business relief.

### Woodland timber

There are special reliefs for woodland timber which allow the value of the timber (but not the land on which it sits) to be exempted from an estate.

### National Heritage

There are special rules for national heritage property and famous and important works of art.

### Recurring annual gifts out of surplus income

This is a commonly used exemption for wealthy taxpayers. Gifts which are made from surplus income which do not result in a fall of the standard of living of the donor are exempt from inheritance tax. There is no published limit to this relief; the amount that can be given is only restricted by a taxpayer's surplus income. This includes monthly or other regular payments to someone, regular gifts for Christmas and birthdays, or wedding/civil partnership anniversaries, regular premiums on a life insurance policy - for you or someone else.

### Annual gifts out of capital

Taxpayers may gift up to £3,000 per year to an individual without a charge to inheritance tax. The annual exemption may be carried forward by one year but not thereafter.

### Small gifts out of capital

Taxpayers may give gifts of up to £250 per recipient per tax year without incurring any inheritance tax charge. The exemption does not apply where the gift exceeds £250.

### Gifts on marriage

There are also reliefs for wedding gifts. A parent may gift up to £5,000 with no inheritance tax liability and grandparents and great-grandparents up to £2,500. There is also a general limit for gifts on marriage of up to £1,000 (per donor).

### **Potentially Exempt Transfers**

As indicated earlier, most gifts made during a person's life are not subject to tax at the time of the gift. These lifetime transfers are known as 'potentially exempt transfers' or 'PETs'. These gifts or transfers achieve their potential of becoming exempt if the taxpayer survives for more than seven years after making the gift. If the taxpayer dies



made on death. A tapered relief is available if death occurs between three and seven years after the gift is made.

The rules surrounding PETs have resulted in many people wanting to make gifts long before they die. The problem in practice is that they do not want to give up control over the assets concerned. A common example is a person giving their house away but continuing to live in it rent-free. Such gifts are known as 'gifts with a reservation of benefit'. The taxman does not accept that a true gift has been made so the 'gift' remains subject to inheritance tax even if the taxpayer dies more than 7 years later.

Over the years many schemes have been developed in an attempt to get around the rules surrounding 'gifts with reservation'. However, the tax rules have been tightened up to make this all but impossible now.

## **Inheritance Tax Planning**

### Making a will

Even if no inheritance tax is going to be due when you die it is important to write a will. If you do not do this you will die intestate and you will have no control as to who inherits your belongings. The rules of intestacy rarely operate how you might expect. They are especially unwelcome in many cases involving single people, married people with children and couples who live together but who are not married or in a civil partnership.

Your will can also be used to arrange the transfer of your assets to keep the inheritance tax due on death to a minimum.

### Trusts

A trust is an obligation that binds a trustee (which can be an individual or a company) to deal with your assets - such as land, money, shares or even antiques - for the benefit of one or more 'beneficiaries'. The trustees are the ones who make decisions about how the assets in the trust are to be managed, transferred or held back for the future use of the beneficiaries.

Much inheritance tax planning involves the careful use of trusts – both those that may be established during your lifetime and those that are established by your will when you die.

There are a number of different types of trusts. Each is subject to different tax rules such that it is important to ensure that any planning exercises create the desired type of trust so that the overall tax burden is kept to a minimum.

## **Record keeping**

You should keep a record of any gifts you make and record any exemptions that you use as well as details of what you intend should be treated as regular gifts made out of surplus income.



Executors or personal representatives must keep:

- a copy of the will and all signed Inheritance Tax forms
- a copy of all signed Inheritance Tax forms
- the necessary paperwork from the death of a first spouse or civil partner if any unused inheritance tax threshold is to be transferred.

### **How we can help**

We would welcome the opportunity to assist you in arranging a review of your affairs to identify the prospective inheritance tax payable on your estate at death. We could then discuss with you the steps that you could take to reduce this liability. Some such steps could be quite straightforward. If the sums involved warrant more extensive planning and you wish to consider this we can help you here too.