

Briefing Note

Summary of Inheritance Tax Reliefs

Inheritance Tax – The Basics

Inheritance tax, or IHT, is chargeable on everything of value. Although usually associated with death, IHT is also levied on certain lifetime transactions. To demonstrate how it all works in practice, we have put together a basic guide to IHT.

When does IHT apply on death?

Every individual has a Nil Rate Band (NRB) which is a fixed threshold set each year by government. The NRB usually increases each year, but the current NRB threshold of £325,000 has been frozen up to and including tax year 2020/21. On death, once the value of an individual's taxable estate exceeds the threshold, IHT becomes chargeable at a rate of 40%. For example, if a person dies leaving an estate worth £500,000 (after deduction of debts, exemptions and reliefs), IHT will be chargeable on the remaining £175,000, giving an IHT bill of £70,000.

Transferable Nil Rate Band

If a person does not use up all or some of their available NRB on death and they leave behind a surviving spouse or civil partner, the NRB in place at the surviving spouse or civil partner's death will be increased by the proportion of the NRB that was not used on the earlier death. If 100% of the predeceasing spouse's NRB is transferable to the survivor then, based on current allowances, this could mean a total NRB of £650,000. Where the spouse exemption applies (see below), even if a person's estate exceeds the NRB, a transferable NRB will be available on the second spouse's death where the predeceasing spouse leaves their entire estate, or the majority of it, to the survivor. This entitlement must be elected by the executors of the surviving spouse or civil partner within 2 years of their death.

Main Residence Nil Rate Band

An additional NRB was introduced in April 2017 and applies where an individual leaves their main residence to a direct descendant on their death and subject to a tapered withdrawal where the value of the net estate is more than £2 million before any reliefs or exemptions are applied. Where available, the residence nil rate band is in addition to the transferable NRB and the threshold has been fixed as follows:

- £100,000 in 2017 to 2018
- £125,000 in 2018 to 2019
- £150,000 in 2019 to 2020
- £175,000 in 2020 to 2021

Lifetime gifts

If no exemptions or reliefs apply to a transfer (see below), then it is either immediately or potentially subject to IHT and it will fall in to one of two categories:

- (i) Potentially Exempt Transfers (PETs)
- (ii) Chargeable transfers

Potentially Exempt Transfers (PETs)

PETs to an individual

When an individual makes a gift to a person, the value of the gift following the application of any exemptions or reliefs is regarded as a PET. This means that although no IHT is payable at the time of the PET, if the donor fails to live for seven years from the date of the transfer, it becomes chargeable. However, if the donor lives at least 7 years (and has not reserved a benefit in the gifted asset, e.g. gifting a house but continuing to live in it), the transfer is not subject to IHT.

PETs to a trust

Since 22nd March 2006, only transfers into a disabled trust and premium payments on certain life policies are regarded as PETs; the rest are chargeable.

Taper relief

Where a person dies within 7 years of making a PET, the transfer is deducted from the NRB available at the time the gift was made and, provided that the donor survived at least 3 years after making the gift, the IHT bill will be reduced by taper relief. This relief is calculated on a sliding scale as follows:-

Years between making gift and death of donor	Taper relief	Effective rate of IHT
0-3	0%	40%
3-4	20%	32%
4-5	40%	24%
5-6	60%	16%
6-7	80%	8%

Chargeable transfers

Everything that is not regarded as a PET or covered by exemptions, Agricultural Property Relief or Business Property Relief (see below) is immediately chargeable at the lifetime IHT rate of 20%. Each person has a rolling seven year NRB, so a cumulative total of chargeable gifts made in the previous 7 years is taken into account when assessing whether or not the NRB has been exceeded.

Chargeable transfers and trusts

Generally, all transfers to trusts made after 22nd March 2006 are chargeable transfers, subject to the lifetime IHT rate of 20% to the extent that the value of the transfer exceeds the donor's available NRB.

Exemptions

The main exemptions are as follows:-

Annual exemption

Each individual may gift up to £3,000 per year, either as one gift or many, without attracting IHT. Any unused balance may be carried forward to the next tax year only.

Small gifts exemption

Each individual can gift up to £250 to the same person in any one tax year, for example on birthdays. There is no limit to the number of donees, as long as the total of all the gifts made from the donor to that specific recipient does not exceed £250.

Regular gifts out of excess income

In order to obtain the exemption, the gift must:

- (i) Be part of the donor's normal expenditure
- (ii) Be made from post-tax income; and
- (iii) Must not reduce the donor's standard of living

Gifts in consideration of marriage or civil partnership

The amount available will depend on the donor's relationship to the person getting married or entering a civil partnership, as set out below:-

- (i) Parents can each give £5,000 to their child on the event of their marriage/civil partnership
- (ii) Grandparents can each give £2,500
- (iii) Any other person can give £1,000

Transfers between UK domiciled spouses and civil partners

Three main scenarios arise here:

- (i) UK domiciled spouse/civil partner – UK domiciled spouse/civil partner: these transfers are not subject to IHT.

- (i) UK domiciled spouse/civil partner – non-UK domiciled spouse/civil partner: these transfers are only subject to IHT if they exceed the NRB allowance at the date of the transfer. However, a non-UK domiciled spouse/civil partner can elect to be treated as UK-domiciled for IHT purposes.
- (ii) Non-UK domiciled spouse/civil partner – non –UK domiciled spouse/civil partner: transfers of UK-situated property are not subject to IHT.

Charitable donations

Gifts to charities, universities, certain political parties and gifts for national purposes to qualifying bodies, such as the National Trust, are not subject to IHT.

Reliefs

BPR and APR

There are other transfers that can qualify for either a full or partial relief from IHT. These are related to business assets (Business Property Relief) and agricultural property (Agricultural Property Relief).

Armed Forces

If a member of the armed forces is killed in action or due to an injury sustained on active duty, their estate is exempt from IHT.

This note is intended as a brief summary of IHT reliefs as at August 2017. Taxation is subject to change and depends on the individual circumstances of each client. Legislation is also subject to change. No responsibility can be accepted for any action taken in reliance of this note and specialist advice should be taken in every case. Turcan Connell would be happy to provide such advice.

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