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Inheritance Tax

It is always sensible to consider the rules relating to Inheritance Tax (IHT) before considering how to plan to avoid it, since if no IHT liability is revealed then then IHT planning action need not be taken.

IHT is charged on an individual's estate on death; and on gifts to certain trusts and on an on-going basis in those trusts.

An individual's domicile affects what is charged to IHT:

- A UK domiciled individual (which includes those who have been resident in the UK for at least 15 of the previous 20 tax years) is subject to IHT on their worldwide estate
- An individual who is not domiciled in the UK is subject to IHT on their UK estate only

A non-UK domiciled individual who has or had a UK domiciled spouse or civil partner can elect to be UK domiciled for IHT.

The general information provided here:

- Relates to IHT payable on death only
- Assumes that UK domiciled status for IHT will apply
- Refers to "spouse" only (which includes same sex married couples), but should be read to mean "civil partner" also. Similarly, references to a "married couple", "marriage", "wedding" or "divorce" also mean a "couple in a civil partnership", "civil partnership ceremony" and "dissolution of a civil partnership"

IHT is calculated on an individual's estate which can include:

- Property, cash, investments, death benefits from life insurance and pensions plans, and personal possessions
- A share of assets jointly held with someone else
- Certain gifts (including the sale of an asset at less than its full market value) made in the seven years prior to death
- Assets given away by the individual at any time prior to death but which they continued to use (known as Gifts with Reservation of Benefit (GROBs))
- Assets held in some types of trust

IHT is charged at the following rates:

- On the nil rate band amount, the rate of tax is 0%
- On the balance, the rate of tax is 40% (or 36% where 10% or more of the net estate is given to charity)

What is the nil rate band?

The nil rate band is the amount chargeable to IHT at 0%. Each individual has a maximum nil rate band of £325,000, but this can be used up by gifts made within seven years prior to death, or gifts made at any time prior to death if caught by the Gift with Reservation of Benefit (GROB) rules which state that if the individual enjoyed a significant benefit in the asset given away then it will remain part of the taxable estate.

What is the transferable nil rate band?

The transferable nil rate band allows a surviving spouse to "inherit" the unused percentage of their deceased spouse's nil rate band. This can potentially double the surviving spouse's nil rate band. The value of the deceased spouse's estate is irrelevant; it is how much of the nil rate band, in percentage terms, the deceased spouse's estate used up that determines the unused percentage that can be transferred to the surviving spouse.

If the surviving spouse remarries, any unused nil rate band from the deceased spouse can still be claimed, subject to a maximum of one additional nil rate band, to cover those who have been widowed more than once.

What is the residence nil rate band?

The residence nil rate band allows an individual to leave a residence to direct descendants free of IHT, subject to the maximum amount available. A surviving spouse can "inherit" the unused percentage of their deceased spouse's residence nil rate band. The rules are complicated and so our residence nil rate band guide should be considered.

What exemptions and reliefs are available?

Exemptions available for lifetime gifts only:

- Normal expenditure out of income
- Small gifts to any one person
- Wedding gifts
- Annual exemption

The detail relating to these exemptions is set out in the "Inheritance Tax Planning: Asset Reduction" guide.

Exemptions available for lifetime gifts and on death:

- Gifts to a spouse
- Gifts to charities

Gifts to a spouse are exempt from IHT, although a UK domiciled individual can only transfer an amount equal to the nil rate band to their non-UK domiciled spouse free of IHT.

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Gifts to charity are exempt from IHT. If at least 10% of an individual's net estate is left to charity, the rate of IHT due on the remainder of the estate is reduced to 36% from 40%.

Exemptions available on death only:

- Certain deaths of members of the armed forces, emergency service personnel and humanitarian aid workers

There is an exemption from IHT on the death of an individual who was a member of the armed forces, or emergency services or humanitarian aid workers, and whose death was caused or hastened by injury or disease received or aggravated whilst on active service or responding to emergencies.

Reliefs available for lifetime gifts and on death:

The following reliefs may be available to reduce the IHT due:

- Business Property Relief
- Agricultural Property Relief
- National Heritage property
- Woodland Relief (available on death only)
- Quick Succession Relief (available on death only)

Business Property Relief (BPR)

BPR is a tax relief on ownership of trading businesses, but not investment businesses such as those dealing mainly in land or buildings. BPR is available on cash which has been used for the business on an on-going basis, but not on cash that has been lying dormant. BPR is denied if the business asset was subject to a contract for sale at the date of death.

Once assets which qualify for BPR are held for two years, they qualify either for 100% or 50% relief from IHT on death:

- 100% relief is available for unquoted shareholdings and business interests (whether a sole trader or partnership)
- 50% relief is available for shares in a quoted company (where the individual had control of the company)
- 50% relief is available for assets, such as land / buildings, owned by the individual but used by the business

Agricultural Property Relief (APR)

APR is a tax relief on ownership of farms. Before applying APR, the tax office will consider the following points in turn:

- Is the property agricultural in nature?
- Did the individual occupy the property for the purposes of agriculture throughout the two years before the date of death? Alternatively, did the individual own the property throughout the seven years before the date of death, during which time it was occupied for agricultural purposes by the individual or someone else?
- Has the property been used for "agricultural purposes" throughout the required period?
- Is any farmhouse, cottage or building of a "character appropriate" to the agricultural property?
- What is the agricultural value of the property (which assumes it can only be used as agricultural property)? The relief does not extend to any additional value, such as a house which may be a desirable country residence

APR is denied if the farm asset was subject to a contract for sale at the date of death.

APR reduces the value of agricultural property when calculating any IHT due on those assets. 100% relief applies if:

- The individual had the right to vacant possession of the property immediately before death;
- The individual had the right to vacant possession of the property within the next twelve months;
- Land was let on a grazing licence;
- Property was let on a tenancy beginning on or after 1 September 1995; or
- The transitional provisions for let property apply, on which expert advice is available

Relief is due at a lower rate of 50% in any other case.

BPR may be available on that part of the value of agricultural property which is not eligible for APR.

National Heritage Property

Where an asset is important to the UK's national heritage, IHT can be deferred from generation to generation if the beneficiary promises to allow public access and to preserve it.

Woodland Relief

Woodland Relief defers IHT by excluding the value of the timber from the taxable estate until the timber is disposed of, when the market value of it is charged to IHT. The deceased must have owned the land on which the timber was growing for five years or more, or received it by gift or inheritance.

Quick Succession Relief (QSR)

If an individual dies within five years of inheriting from an estate where IHT was paid on the inheritance, the IHT due on their death can be reduced (on a sliding scale) with QSR.

If consideration of the IHT rules reveals a potential IHT liability then our IHT planning guides should be considered.

Key contacts

For further details and tailored advice, contact:

- Stephen Duffy in Peterborough on 01733 888879
- Duncan Jackson in London on 020 3709 9462
- Sarah Westwood in Stamford on 01780 484570
- Karl Dembicki in London on 020 3709 9460