Inheritance Tax

It was Julius Caesar who first implemented Inheritance Tax (IHT). However, it wasn't until 1796 that 'death taxes' were introduced to the U.K. to finance the war against Napoleon Bonaparte. Death Duties, as they were known, were introduced in 1894 as a way to breaking up large estates as part of a politically motivated way of curbing the influence of the landed gentry. Since then, the law of unintended consequences and rampant house price inflation means that an increasing number of us are subject to IHT. In fact, according to figures released by HMRC, last year (2017-18) the Treasury collected £5.2 billion in Inheritance Tax (IHT).

In many ways IHT is the most unfair of taxes; in that, we pay tax on everything we earn, we pay tax on everything we save, we pay tax on everything we spend and then our heirs have to pay even more tax on what's ever left when we die! That said, there are ways in which you can reduce or even completely remove the need to pay it.

Each us is allowed to give away free of IHT an amount equivalent to what is called the Nil Rate Band (NRB), which currently stands at £325,000. Apart from certain exempt gifts (see below) everything above the NRB is taxed at 40%. One thing to remember is that in calculating how much tax is payable, Her Majesty's Revenue & Customs (HMRC) will take into account everything you own including your family home.

Inheritance Tax Exemptions

<u>Spousal Exemption</u>

Gifts between spouses or civil partners are completely free of IHT, unless that is you're domiciled outside of the U.K. wherein different rules apply. Being married or in a civil partnership currently allows you to double the NRB to £650,000 upon the death of the survivor, but the law can be changed at any time and this concession could be reduced or even removed.

<u>Gifts to U.K. charities</u>

Gifts to charities, institutions such as the National Trust, certain types of heritage property, land to registered housing associations or to established political parties are free of IHT.

<u>Pension Schemes/Active Service</u>

Lump sums paid from pension schemes, refunds of personal pension contributions, or the estate of someone killed on active service are all free of IHT.

<u>Annual Gifts</u>

You can also make tax free gifts during your lifetime such as any number of small gifts of £250 each to any one person and up to £3,000 in total per year of other gifts which can be carried forward one year if unused. You can also make regular gifts out of income as long as your lifestyle remains unaffected. It's a good idea to keep a record of your after-tax income if you make regular gifts out of income as part of your normal expenditure. This will show that the gifts are regular and that you have enough income to cover them and your usual day-to-day expenditure without having to draw on your capital.

Gifts on Marriage
You can make gifts on your children's or grandchildren's marriage (£5,000 from each parent of the bride and groom, and £2,500 from each grandparent)

Maintenance Gifts
Gifts for maintenance of your family such an ex husband, wife or civil partner, children under 18 or still in full time education are free of IHT.

Business Relief
If you own a private trading business and have held the shares for at least two years, then 100% Business Relief (BR) applies. You won't however benefit from BR if the business is wholly or mainly involved in investment activities such as owning Buy-to-Let property. However, without a properly drafted Shareholders' or Partnership Agreement and the concomitant Cross-Option Agreement, you may loose BR entirely. Speak to one of our advisers for further information.

In a not dissimilar vein, certain types of commercially available investments are available, of which some become IHT free after only two years.

Agricultural Property Relief
If you're involved in agriculture, then Agricultural Property Relief (APR) applies.

Who pays Inheritance Tax and when?
Where an estate is liable to Inheritance Tax, it must be paid before Probate is granted, i.e. before the Will is officially recognised. That means that any IHT liability must be agreed and paid within six months of the end of the month in which death occurred, after which interest will usually be added, before any assets are distributed to the beneficiaries.

It will help your executor or personal representative to sort out your financial affairs when you die if you keep a record of any gifts you make and note on that record which exemption you've used.

Assets cannot usually be distributed until the IHT bill has been settled. However, solely at HMRC's discretion, liabilities based on the deceased person's home and any other land or buildings in the estate may be paid by instalments over 10 years. HMRC is a preferential creditor and has the right to be paid first, thus assets such as the family home may have to be sold to meet the tax bill.

Can I give my home to my children and continue to live there to reduce my IHT bill?
Unless you're paying a market rent to remain there as a tenant, HMRC will regard this as what is known as a 'gift with reservation of benefit', and thus disregard the transfer when calculating the IHT bill. As a general rule, gifts with strings attached are treated as if they had not happened and you should be very wary of complex trust-based schemes that purport to take the family home outside of the IHT trap without requiring you to pay a market rent whilst allowing you to continue living there. Even if you are paying a market rent, there may still be a liability to both income and capital gains tax.

Moreover, if your children divorced or got into financial difficulties, then your 'home' may have to be sold. Lastly, the same rules apply to any asset that you give away and continue to enjoy a benefit from.

Residence Nil Rate Band
Whilst the NRB has been frozen at £325,000 until 2021, individuals now have the opportunity to also claim an additional RNRB – with strings attached. This started to be tapered in in April 2017, and will not fully apply until 2020. Today, an individual could claim an additional £125,000 (rising by £25,000 in April 2019 and April 2020 to reach £175,000) against their main residence, but only if the property/money from the sale of it is going to 'direct' heirs, i.e. children, stepchildren, adopted and foster children.

That said, once the estate value reaches £2m the relief starts to taper off. For a married couple, by the time the estate is £2.7 million, this RNRB has disappeared altogether.

In the event the house has been sold before the death, you may still be able to claim the RNRB due to the down-sizing provisions.

Tax on Lifetime Gifts
If you pass away within seven years of making a gift, IHT extends to include it in your taxable estate. A gift during your lifetime (except those above in the exclusions) will only be tax free if you live for seven years after making it.

If the total value of the gifts you made is greater than the NRB, the IHT on the taxable value above the NRB will be reduced by something called Taper Relief as shown below.

Period of years before death	% reduction (tapering relief)
0-3 years	Nil
3-4 years	20%
4-5 years	40%
5-6 years	60%
6-7 years	80%
More than seven years	No IHT

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