



## **Inheritance tax: an overview**

This note provides a guide to UK inheritance tax (IHT) for those who are unfamiliar with the charge. It covers:

- When IHT is charged.
- The rate of tax.
- The main exclusions, exemptions and reliefs.

This is an overview and is not intended as a substitute for professional advice. IHT is a complex area and many aspects are outside the scope of this guide.

### **When is IHT charged?**

IHT is primarily a charge on your assets on death, including your share of assets jointly held with another person. However, lifetime gifts made within seven years prior to your death can also be brought back into charge.

IHT is also charged where an asset appears to have been given away, but where you in fact retain the use of (or a significant benefit in) the asset given. For example, where you give your home (in which you continue to live) to your children and do not pay them full market rent for your occupation.

It is also charged on lifetime gifts to companies and to certain types of trust (called "relevant property" trusts) and these trusts also suffer periodic IHT charges.

For ease of explanation, the word "gift" is used in this note. However, the IHT legislation is more complex and covers scenarios that might not be immediately recognised as a gift. For example, the legislation covers sales of assets at an undervalue (when made between certain family members, or your company, trust or partnership). Therefore, if you sell a house worth £100,000 to your son or daughter for £10,000, you have effectively made a gift to them of £90,000.

IHT can also cover the use of property and fixed-term interest free loans. Although IHT is a charge on individuals, you cannot avoid IHT by using a company which you control to make gifts on your behalf.

### **Who is liable to IHT?**

If you have lived in the UK all your life, IHT applies to your worldwide assets. If you have not always lived in the UK, see the section on Domicile below.

### **What is the rate of tax?**

- The nil rate band is charged at 0% (see the section on the Nil Rate Band below).
- The balance is charged at:
  - 20% for lifetime gifts to companies or to relevant property trusts (with further tax due if the donor dies within seven years).
  - 40% on estates on death.

The rate of IHT on death is reduced from 40% to 36% for individuals who leave 10% or more of their net estate to charity.

Where lifetime gifts are brought back into charge (because they were made in the seven years prior to death), any IHT payable on these gifts may be reduced. The longer you survive from the date of the gift, the less IHT is payable, provided that you survive for at least three years.

Relevant property trusts have their own IHT regime, which can see IHT charged (at a maximum rate of 6%) every ten years and also when capital is distributed to beneficiaries.

There are, however, various exclusions, exemptions and reliefs which can reduce the amount of IHT payable. These are outlined in brief below.

### **Nil rate band and residence nil rate band**

The nil rate band and residence nil rate band are amounts which are chargeable to IHT at 0%. The basic nil rate band is currently £325,000. There is also an extra nil rate band (called the residence nil rate band) of between £100,000 and £175,000 (depending on the year of death) if the family home is inherited by children or grandchildren.

If you are married, your surviving spouse, or civil partner can "inherit" the unused portion of your nil rate band or residence nil rate band. When a claim is made, this increases the surviving spouse's or civil partner's nil rate band and residence nil rate band on a percentage basis (and not simply by the amount of your unused nil rate band and residence nil rate band).

### **Example**

Mr X died a number of years before Mrs X. On death he had an available nil rate band of £200,000. He left £50,000 to his children and the remainder of his estate (including his half of the family home) to Mrs X (who owns the other half of the family home). The spouse exemption applied to the gift to Mrs X, so it did not use up any of Mr X's nil rate band. The £50,000 gift to his children fell within his available nil rate band and was therefore free of IHT. However, 75% of Mr X's available nil rate band was unused.

When Mrs X dies her executors can claim to transfer the unused percentage of Mr X's basic nil rate band, which would otherwise be wasted. Mrs X did not use up any of her

basic nil rate band of £325,000. She leaves the family home to her children. Her executors can claim a transferable nil rate band in relation to her husband which is worth 75% of her available nil rate band so that £325,000 is increased by a further 75%.

Mr X could not use up any of his residence nil rate band because he left his share of the home to his wife rather than his children or grandchildren. Therefore, Mr X's unused residence nil rate band can be transferred over to be used by Mrs X's executors when they are calculating how much inheritance tax they have to pay. Mrs X's residence nil rate band can be increased by 100% taking into account Mr X's unused residence nil rate band.

The combined basic nil rate bands available to set against Mrs X's estate will be £568,750 (that is, her own nil rate band of £325,000, plus an additional 75% of £243,750). In addition, if Mrs X dies in the tax year 2017/2018, Mrs X's executors can also claim residence nil rate band of £100,000 for Mrs X and carry forward a further 100% of residence nil rate band which was unused by Mr X when he died. The total residence nil rate band is, therefore, £200,000.

In total, £768,750 of Mrs X's estate is charged to inheritance tax at 0% with the remainder being charged at the rate of 40%.

### **Exemptions available for lifetime gifts and on death**

Certain gifts are exempt from IHT and do not use up your nil rate band. Briefly, the main exemptions are as follows:

- Gifts to your spouse, same sex spouse or civil partner.
- Gifts to charities established in the UK, any other EU country, Norway or Iceland.

### **Exemptions available for lifetime gifts only**

Additional exemptions are also available for lifetime gifts, if none of the above exemptions apply. They are as follows:

- Normal expenditure out of income.
- Small gifts: up to £250 to any one individual per tax year is exempt (the exemption is only available if the gift does not exceed £250).
- Wedding or civil partnership gifts: each parent may give the couple £5,000; grandparents and great grandparents may give £2,500; others may give £1,000.
- Annual exemption: £3,000 a year.
- Potentially exempt transfers: outright gifts of any amount become fully exempt if you survive for seven years.

The "normal expenditure out of income" exemption is applied first and the "annual" exemption is applied last, after the application of any other available exemption.

## **Reliefs available for lifetime gifts and on death**

If the gift is of a special type of asset and the necessary conditions are met, relief may apply to reduce the amount of IHT payable, sometimes to nil. The main reliefs are as follows:

- Agricultural property relief: available for farmland and farm buildings anywhere in the European Economic Area (including the UK). Relief is given at either 50% or 100%, depending on the circumstances.
- Business property relief: available for certain business interests and qualifying company shares located anywhere in the world. Relief is given at either 50% or 100%, depending on the circumstances.

## **Domicile**

IHT is chargeable on individuals who are domiciled in the UK, or those who have UK assets.

Individuals who are domiciled in the UK (which for IHT purposes includes those who have been resident in the UK for at least 17 out of the previous 20 tax years), are subject to IHT on their worldwide assets. From 6 April 2017, individuals who have been UK resident for more than 15 out of the last 20 tax years will be deemed to be UK domiciled for all tax purposes.

Individuals who are not domiciled in the UK are subject to IHT on their UK assets only.

Where a married couple or civil partners have different domiciles for IHT purposes, the spouse/civil partner exemption is restricted: gifts from the UK domiciled spouse or civil partner to the non-UK domiciled spouse or civil partner, made before 6 April 2013, are only exempt up to £55,000 (which is an overall limit on gifts made during lifetime and on death). Gifts made on or after 6 April 2013 are only exempt up to the prevailing nil rate band. There is no limit on the exemption for gifts from the non-UK domiciled spouse or civil partner to the UK domiciled spouse or civil partner. Non-UK domiciled spouses and civil partners can also elect to be treated as UK domiciled for IHT to take advantage of the unlimited spouse exemption.

"Domicile" is a complex concept, which is beyond the scope of this note. It has a specific legal meaning, beyond the simple dictionary definition of "place of residence". If you are unclear as to your domicile status, it is important to discuss this with your solicitor at the earliest opportunity.