

OVERVIEW OF INHERITANCE TAX "IHT"

This is a guide to explain how inheritance tax (IHT) applies to an estate.

This note is based on the law as generally understood and takes into account accepted HMRC practice, interpretation, press releases and practice statements. HMRC may change these without warning you first and, generally, may announce changes to IHT at any time.

It is very important to review your will and the value of your assets:

- At regular intervals or at least every five years.
- Whenever there is a significant change in your circumstances.

IHT SUMMARY

What is IHT?

IHT is primarily a charge on your assets on death, including your share of assets jointly held with others. Lifetime gifts made in the seven years before your death can also be brought back into account.

IHT is also charged where an asset appears to have been given away but where, in fact, you retain the use of that asset.

IHT, nil rate band and residence nil rate band

When you die, the IHT charge on your estate is at 0% on the nil rate band at 40% on the remaining balance.

The nil rate band is currently £325,000. However, the nil rate band available on your death can vary as it can be used up by lifetime gifts made in the seven years before your death.

If you give your home to direct descendants such as children and grandchildren or certain other beneficiaries, from 6 April 2017 your estate can benefit from an additional residence nil rate band (RNRB). The other beneficiaries include adopted children, stepchildren and foster children, as well as the spouses and civil partners of all these beneficiaries. The RNRB may also be available if you sell your home and buy a less valuable property, or cease to own a property, and any part of your estate passes to these beneficiaries (this is known as a downsizing addition).

If the RNRB applies, between a further £100,000 to £175,000 of the estate could be taxed at 0%. You can also transfer unused RNRB from a deceased spouse or civil partner. However, the RNRB of each individual is tapered if the value of their estate (before applying any IHT exemptions and reliefs) exceeds £2 million. This limit may change. Currently, the taper means that an estate worth more than £2.2 million cannot benefit from the RNRB.

Please note that if your residence forms part of your residuary estate (because it has not been bequeathed separately), which passes to a mixture of qualifying beneficiaries (i.e. children or grandchildren) and beneficiaries who do not qualify (such as siblings, nieces, nephews or parents), then only a percentage of your residence's value will be available for the Residence Nil Rate Band allowance. If for example 60% of your residuary estate (which includes your residence) passes to your grandchildren and 40% passes to your nieces and nephews, only 60% of the value of your residence will be available for the Residence Nil Rate Band.

Main exemptions for lifetime gifts and on death

Certain gifts are exempt from IHT and do not use up your nil rate band. The main exemptions are:

- Gifts to charities established in the UK (the charity exemption).
- Gifts made regularly out of surplus income.

Potentially exempt transfers (PETs)

An outright gift to an individual is potentially exempt from IHT and becomes fully exempt if you survive for seven years from the date of the gift. If you do not survive for seven years, the gift becomes chargeable to IHT but will be taxed at 0% if its value falls within your nil rate band. Even if IHT does become payable, the longer you survive after making the gift (subject to surviving at least three years), the lower the IHT charge on the gift on a sliding scale. The charge is reduced by 20% for each year that you survive after the third year, with a maximum 80% reduction if you survive for between six and seven years.

Domicile

If you are domiciled in the UK, you are subject to IHT on your worldwide assets. If you are domiciled outside the UK, you are only subject to IHT on your UK assets. Domicile has a specific legal meaning for UK tax purposes, beyond the simple dictionary definition of place of residence. You may acquire a UK deemed domicile for IHT if you have lived in the UK for a long time. If you are unclear about your domicile status, I can look into this in more detail for you.

Where does the burden of IHT fall?

Where the burden of IHT falls, that is which assets may be used to pay the IHT, depends on what is in your estate when you die and the provisions of your will.