Carter Lemon Camerons LLP

Solicitors

Private Client Department

Guide to Inheritance Tax

What is Inheritance Tax?

Inheritance Tax (IHT) is a levy placed on estates of a certain size and is payable upon the owner's death. It was introduced in 1986 as a replacement for Capital Transfer Tax.

At the time, Margaret Thatcher's government had envisioned that the tax would only apply to the very wealthiest residents of the UK.

In recent years however there has been growing controversy about the increasing number of people with more modest estates who have found themselves paying the tax, chiefly as a result of rising house prices. In the financial year 2014/15, HM Revenue & Customs (HMRC) collected £3.8billion in revenue – a 23 per cent increase on the previous 12 months.

In his second Budget of 2015, Chancellor George Osborne finally bowed to pressure to reform IHT, announcing a series of measures designed to cut the bill for middle-income families. These changes are set to be phased in over the course of the next five years.

In the meantime, or for those who will still be liable to pay IHT even after the changes take effect, there are a number of ways to legally minimise the amount of tax you will have to pay on your estate.

This guide offers an introduction to Inheritance Tax and how the rules operate, but it should be taken only as a summary of a notoriously complicated subject and it is important that individuals who want to clarify an aspect of the law or who are looking to reduce their liability seek expert legal advice.

If you have further questions, the team at Carter Lemon Camerons will be happy to assist.

What are the current rules?

Under the present system, if an individual's estate (their property, money and other assets) is worth more than £325,000 at the time of their death then they will be liable to pay Inheritance Tax. This is set at a rate of 40 per cent on all assets above the £325,000 threshold.

Those whose estate is worth less than this amount come under the "nil-rate-band" and do not have to pay the levy. It is worth noting that married couples and civil partners (but not those who are cohabiting) can combine their allowance. This means that the couple can pass on assets worth up to £650,000 tax-free.

IHT is usually paid to the tax authority by the executor of a will, the administrator of an estate, or the trustees if the tax has been placed in a trust.

Under normal circumstances, an executor or administrator will have to pay the tax owed by the end of the sixth month following the person's death. After this point, the estate will start to owe interest.

In instances where it may take time to sell an asset – for example a property or certain types of shares – then HMRC can make provision for IHT to be paid in instalments over a period of up to ten years.

How are these rules set to change?

In July 2015, George Osborne announced sweeping changes to the way IHT will work. He argued that a growing number of middle-income families had found themselves dragged into the tax bracket and that this needed to be addressed.

To this end, the Government will be introducing a family home allowance to the existing tax-free allowance. This will come into effect on 6th April 2017 and will originally be set at £100,000 per person. It will then rise to the sum of £175,000 by April 2020.

This will mean that by the end of the current Parliament, individuals will be able to pass on assets worth up to £500,000 tax-free. For married couples and civil partners, who will still be able to combine their tax-free allowance, the threshold for IHT will rise to £1million.

However, not everyone will benefit from the new system. The family home allowance is chiefly designed to protect modest estates and if your assets are worth more than £2million, the allowance will gradually taper away.

There has also been concern that those without any direct descendants will not benefit from the changes. Under the laws being drawn up by the Government, the family home allowance will only apply to assets passed down to children – including stepchildren, foster children and adopted children – and grandchildren.

Reducing your IHT liability

There are several options available for reducing Inheritance Tax liability or avoiding paying it altogether. These are completely legal, but there are conditions attached and it is important to seek expert legal advice on the options available to you. The following sections will cover some of the most common methods of reducing IHT bills.

Gifts

Inheritance Tax may not apply to assets that the deceased gave away as gifts while they were still alive.

Under law, a gift is defined as:

- Any asset that has financial value, including money, property or possessions;
- A loss in value when something is transferred. For example, if a couple choose to sell a house to a child for less than it's worth, the difference in the two sums is classed as a gift.

An individual must live for at least seven years after giving a gift for it to be entirely excluded from IHT considerations. If less than seven years has elapsed, then the gift counts towards the IHT threshold (currently £325,000). If the deceased gave away more than £325,000 in gifts in the final seven years of their life, then tax is due on anything above this amount.

However, if a gift is received between three and seven years before the donor's death, then the rate of IHT will be reduced. This is commonly known as taper relief and the rates of reductions are covered in the table below.

Number of years between gift and death	Rate of Inheritance Tax (IHT) to be paid	Effective tax rate (if not qualified for reduced rate)
Less than 3	100 per cent	40 per cent
3 to 4	80 per cent	32 per cent
4 to 5	60 per cent	24 per cent
5 to 6	40 per cent	16 per cent
6 to 7	20 per cent	8 per cent

Gifts exempt from Inheritance Tax

An estate does not have to pay IHT on up to £3,000 worth of gifts which have been given away in each tax year. This is often referred to as the "annual exemption."

If the amount given away in gifts is less than £3,000 the annual exemption can be carried over into subsequent tax years, although the amount can never exceed £6,000.

There are certain types of gifts which don't count towards the annual exemption. Gifts that fall into this category include:

- Wedding gifts worth up to £5,000 to a child, £2,500 to a grandchild or great-grandchild, or £1,000 to anybody else. To qualify, the gift must be given on or shortly before the day of the wedding or civil partnership.
- Gifts of up to £250. You can give sums up to this amount to as many people as you like in a single tax year. However, you can't give the same individual another £250 if you've already given them a gift under a different exemption.
- Regular gifts from the deceased's income such as Christmas, birthday and anniversary presents and life insurance policy premiums. Although only so long as the deceased still had enough money to maintain their current lifestyle.
- Payments given to help other people with their living costs. These include payments to an ex-spouse or a child under 18-years-old or in full-time education. Also included would be relatives who are dependent on the individual because of old age, an illness or disability.
- Gifts paid to charities, museums, universities or amateur sports clubs.
- Gifts to political parties that have, either, at least two MPs or at least one MP and 150,000 votes at a General Election.

Giving to charity

If an estate leaves 10 per cent of its "net value" to charity then it is able to pay Inheritance Tax at a reduced rate of 36 per cent on some of its assets.

The net value of the estate is calculated once debts and liabilities, reliefs, exemptions and the £325,000 nil rate band have been deducted. To qualify for the rate, the assets must be left to organisations that have a HMRC charity reference number or are classed as community amateur sports clubs.

It should be noted that the executor of a will or administrator of an estate can choose to opt-out and pay the usual 40 per cent IHT rate, providing the beneficiaries agree. Some people may prefer to do this as the cost of getting assets professionally valued may actually outweigh the financial benefits of the reduced rate.

Inheritance Tax reliefs

Under UK law there are several reliefs which reduce or remove the liability of Inheritance Tax for certain types of assets. It is important that the executor of a will or administrator of an estate takes advantage of these rules if they apply.

Business Relief – This allows a business to be passed on as a going concern either while the owner is still alive or in the Will following their death. Depending on the circumstances, the relief will reduce IHT by 50 per cent or remove the liability altogether.

Agricultural Relief – Under current legislation, a working farm can be passed on as a going concern without paying IHT. Certain conditions relating to the location of the farm, length of ownership and several other matters have to be met to qualify for this.

Woodland Relief – You don't include the value of timber in a woodland when calculating the value of the estate. However, whoever inherits the woodland may still have to pay IHT when they sell the timber, unless it also meets the criteria for Business or Agricultural Relief.

Heritage Assets – There are certain buildings, pieces of land or artworks that may be exempt from IHT if they have special historic or scientific interest. To qualify for the exemption, they must be made available for public view and meet a number of other criteria.

Death in Service Exemption – If a member of the armed forces, emergency services or a humanitarian aid force has died in active service or during an emergency then their estate doesn't have to pay IHT.

Living abroad

If an individual dies while living abroad, this may affect how much Inheritance Tax they have to pay. Factors that need to be taken into account include:

- How long the deceased had been living overseas.
- Whether their assets are in the UK or abroad.
- If those assets in the UK are "excluded assets".
- If the assets had been put into a trust.

For advice on the bearing these factors will have, you should seek legal advice.

Trusts and Inheritance Tax

Putting cash, property or other assets into a trust has been a key part of Inheritance Tax planning for many years.

When setting up a trust you must state clearly when it will become active, who the trustees and beneficiaries are and what assets are included.

The assets put into a trust for the benefit of a third party no longer belong to the individual and as a result they won't normally be taken into consideration when calculating an estate's IHT liability.

There are several different types of trust to choose from. Some are written into a Will, while others can be set up immediately. It is important to note that some are still eligible for Inheritance Tax in their own right, while others may be liable for Income Tax or Capital Gains Tax. Depending on your circumstances you can also choose to base your trust in the UK or overseas.

Leaving assets to a spouse or partner

If an individual leaves the entirety of their estate to their husband, wife or civil partner – and that person lives permanently in the UK – then it is not liable for Inheritance Tax. It is important to note that unmarried couples who live together are not entitled to the same exemption.

Also, if an individual's estate is worth less than £325,000 (the current IHT threshold) then the remaining threshold can be transferred to their husband, wife of civil partner when they die. This is handled by the administrator of the estate of the executor of the will.

This effectively means that the surviving partner's estate can be worth up to £650,000 before they are liable to pay IHT to the tax authority.

While the threshold can be transferred even if the surviving husband, wife or civil partner remarries, there are a few exceptions to the current rule and it is important to seek a solicitor's advice if you are unsure whether you are eligible.

In addition, an executor or administrator must ensure that they have kept comprehensive records that are proof of any unused IHT threshold. These will be needed in order to complete the transfer.

Contact Carter Lemon Camerons for advice

At Carter Lemon Camerons we understand that people want to pass on their assets to their loved ones. We can advise individuals on the options available for minimising or avoiding Inheritance Tax, through the use of gifts, trusts, charitable exemptions and other arrangements.

Our experienced team of lawyers takes pride in a thorough yet sensitive approach and will work to achieve the best possible outcome for our clients.

For more details, please contact a member of our private client team.

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