

Fact sheet: Inheritance Tax



LUCAS FETTES

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Inheritance Tax is usually paid on an estate when somebody dies. It's also sometimes payable on trusts or gifts made during someone's lifetime. Most estates don't have to pay Inheritance Tax because they're valued at less than the threshold (£325,000 in 2022/23). The tax is payable at 40 per cent on the amount over this threshold. The standard Nil Rate Band will remain at this level until April 2026.

Married couples and registered civil partners can effectively increase the threshold on their combined estate when the second partner dies - to as much as £650,000 in 2022/23.

If your estate is worth more than the Inheritance Tax threshold there are some important Inheritance Tax exemptions that allow you to make gifts to others and not have to pay tax on them when you die.

The July Budget of 2015 announced the introduction of the Main Residence Nil Rate Band (RNRB) for Inheritance Tax purposes, to be set against the value of the family home. The RNRB gives each individual who has died after 6 April 2017 an additional allowance to be used against their home (or their interest in their home) provided they leave the property to their direct descendants. Any unused RNRB will be transferable between spouses and civil partners if it is unused on first death. The RNRB is £175,000 in 2022/23.

The basic conditions for the RNRB indicate that many could miss out on the benefits.

- The property must be left to direct descendants, which includes children, stepchildren, adopted and foster children i.e. not siblings, nieces/nephews, wider family members or friends.
- There is a tapered reduction of the RNRB where an estate (before deducting any reliefs or exemptions) exceeds £2m, with no RNRB for estates worth more than £2.35m for death occurring after 6 April 2020, increasing to £2.7m where the RNRB is fully transferred on first death of a married couple. Those with valuable business or agricultural property, for example, may therefore find no RNRB is available.
- The RNRB can only be set against the net value of a property, which may mean little is available if there is a mortgage or equity release, even if the overall estate is valuable.
- The relief is assessed at each death. If the first spouse to die has an estate exceeding £2.35m they are not entitled to any RNRB, and so it cannot be transferred to the surviving spouse. The survivor should, however, be able to claim their own RNRB.
- Property left to a discretionary Will trust will have to rely on legislative provisions which, if exercised within two years of death, can redirect eligible property to lineal descendants in order to secure the relief. There is, of course, no guarantee that these legislative provisions will still be in force at the time of death.

How are lifetime gifts treated for Inheritance Tax?

For Inheritance Tax, an individual who makes a gift during their lifetime may be treated as making:

- an exempt transfer; or
- a potentially exempt transfer (PET); or
- a chargeable lifetime transfer (CLT).

No Inheritance Tax is payable on exempt transfers.

Potentially exempt transfers will only become subject to Inheritance Tax where death occurs within seven years of the transfer.

Chargeable lifetime transfers are subject to Inheritance Tax at 20 per cent at the time of the gift if the value of the gift, plus any previous CLTs within the last seven years, exceeds the Nil Rate Band. Where death occurs within seven years of making a CLT, Inheritance Tax will be recalculated at the death rate of 40 per cent but with credit given for any Inheritance Tax paid at outset.

It is possible for a single gift to be part exempt and part PET or CLT. For example, a gift into a discretionary trust could be partially covered by the £3,000 annual exemption with the excess being a CLT.

Periodic and exit charges may also apply where a CLT has been made.

Exempt gifts

You can make gifts to certain people and organisations without having to pay any Inheritance Tax. These gifts are exempt whether you make them during your life or as part of your will.

You can make exempt gifts to:

- your husband, wife or civil partner, as long as they have a permanent home in the UK;
- a 'qualifying' charity established in the EU or another specified country;
- some national institutions such as museums, universities and the National Trust; and
- any UK political party that has at least two members elected to the House of Commons or has one elected member, but the party received at least 150,000 votes.

Gifts that you give to your unmarried partner, or a partner that you're not in a registered civil partnership with, are not exempt.

The following Inheritance Tax exemptions are available for gifts made during lifetime only:

Annual exemption – you can give away gifts worth up to £3,000 in total in each tax year and these gifts will be exempt from Inheritance Tax when you die. You can carry forward any unused part of the £3,000 exemption to the following year, but if you don't use it in that year, the carried over exemption expires.

Wedding gifts/civil partnership ceremony gifts – subject to certain limits.

- Parents can each give cash or gifts worth £5,000.
- Grandparents and great grandparents can each give cash or gifts worth £2,500.
- Anyone else can give cash or gifts worth £1,000.

You have to make the gift – or promise to make it – on or shortly before the date of the wedding or civil partnership ceremony.

Small gifts - you can make small gifts up to the value of £250 to as many different individuals as you like in any one tax year.

Regular gifts - payments that are part of your normal expenditure, you make these out of your after-tax income. These are exempt from Inheritance Tax, as long as you have enough income left after making them to maintain your normal lifestyle. These gifts cannot come from capital savings.

These include:

- monthly or other regular payments to someone;
- regular gifts for Christmas and birthdays, or wedding/civil partnership anniversaries; and
- regular premiums on a life insurance policy – for you or someone else.

Payments to help with living costs

There's no Inheritance Tax on gifts to help with other people's living costs.

These include payments to:

- an ex-husband, ex-wife or former civil partner;
- a relative who is dependent on them because of old age, illness or disability; and
- a child (including adopted children and stepchildren) under 18 years old or in full-time education

The seven-year rule – Potentially Exempt Transfers (PETs)

Any gifts you make to individuals will be exempt from Inheritance Tax as long as you live for seven years after making the gift. These sorts of gifts are known as Potentially Exempt Transfers (PETs).

If you die within seven years and the total value of gifts you made is less than the Inheritance Tax threshold, then the value of the gifts is added to your estate and any tax due is paid out of the estate.

However, if you die within seven years of making a gift and the gift is valued at more than the Inheritance Tax threshold, Inheritance Tax will need to be paid on its value, either by the person receiving the gift or by the representatives of the estate.

If you die between three and seven years after making a gift, and the total value of gifts that you made is over the threshold, any Inheritance Tax due on the gift is reduced on a sliding scale. This is known as 'taper relief'.

If you give an asset away at any time but keep an interest in it – for example you give your house away but continue to live in it rent-free – this gift will not be a PET and will still form part of your estate for IHT.

Business Relief (formerly Business Property Relief) – allows you to pass on some of the business assets in your estate free of Inheritance Tax. You can pass these assets on while you're still alive or as part of your Will.

You can claim relief on property and buildings, or assets such as unlisted shares or machinery. Depending on the type of asset, they'll qualify for relief of either 50 per cent or 100 per cent, providing they meet the criteria.

Agricultural Relief – if you own agricultural property and it is part of a working farm, you can pass on some of your property free of Inheritance Tax in your Will or before you die. You can claim relief for farm property such as farmland. You can also claim relief for farm buildings if the size of the buildings is proportionate to the size of the farming activity. Relief is not available for farm equipment but it may qualify for Business Property Relief as a business asset. Depending on the type of property, it will normally qualify for relief of 100 per cent.

Woodland Relief – when you die, the beneficiaries of your woodland can ask that the value of the timber – but not the land – be excluded from your estate. However, when the timber is sold, the beneficiaries may have to pay Inheritance Tax on the value of the sale unless it also qualifies for relief.

Relief for National Heritage assets – some assets may qualify for relief from Inheritance Tax under certain very strict and exceptional conditions. Examples of assets that may qualify include:

- buildings of outstanding historic or architectural interest; and
- objects which have national scientific, historic or artistic interest.

These conditions include an agreement to maintain and preserve the assets. They must also be made available to the general public to view.

The importance of keeping records

It will help your executor or personal representative to administer 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.

It's also 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.

Contact us

If you would like further information on any of the above services or how we can help you, please do not hesitate to contact your Lucas Fettes Financial Planning adviser, call us on **01603 706 820** or email **info@lffp.co.uk**.

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