



# Inheritance Tax in a nutshell

Protecting your estate  
for future generations

Audit / Tax / Advisory / Risk

Smart decisions. Lasting value.

# What is Inheritance Tax?

Inheritance Tax (IHT) is charged on the transfer of value to others. It is a tax most of us come across when someone dies and passes on their assets on death. In some circumstances IHT becomes payable earlier — for example, if you put assets into certain types of Trusts.

## Who pays Inheritance Tax?

People who are domiciled in the UK are charged IHT based on the assets they own in the UK and worldwide. Those who are not UK domiciled are only charged IHT on their UK assets. This includes all UK residential property, owned by non-domiciled individuals, held within offshore structures such as Trusts and companies.

Domicile is a legal term. Your domicile is usually the country you

- regard as your permanent home. On birth, your domicile is taken from your father, although it can be shifted to another country if you have taken deliberate steps to settle elsewhere. From April 2017, if you have been resident in the UK for at least 15 of the past 20 tax years, you are treated as UK domiciled for IHT purposes ('deemed domicile').

This rule also applies to individuals who are born in the UK to parents domiciled in the UK, while they remain in the UK.

# Inheritance Tax on death

When someone dies, IHT needs to be considered. To evaluate whether or not tax is payable, all of the assets the person held at the date of death need to be valued, and reliefs and exemptions determined. The total is known as the deceased's 'estate' or 'death estate'.

## **Tax rates**

IHT is currently charged on the value of the estate, after reliefs and exemptions plus certain lifetime transfers made in the last seven years. The tax is charged at 0% up to the IHT threshold, currently £325,000 (known as the nil rate band) and 40% on the balance of the estate.

The 40% rate is reduced to 36% where at least 10% of the net estate is left to UK or certain EU registered charities.

Each person has a nil rate band, currently £325,000, which allows for an estate of up to that amount to be left with no IHT liability. Married couples and civil partners have one nil rate band each.

A nil rate band can be transferred when a spouse or civil partner has died and their estate charged to IHT does not use up all of the nil rate band they are entitled to.

Assets that pass from one spouse or civil partner to another are exempt from IHT.

So, if on death, you leave everything you own to your spouse or civil partner, it is exempt from IHT and you will not have used any part of your personal nil rate band. Your unused nil rate band can be transferred to your spouse or civil partner and is used to work out the IHT liability on their estate when they die. This means that when your spouse or civil partner also dies, a maximum of two nil rate bands will be available, currently totalling £650,000.

The nil rate band has failed to keep pace with inflation and is expected to remain at the same level until April 2021. This means more and more estates are likely to be charged IHT.

### **The spouse exemption: non-domiciled spouses**

Transfers between UK domiciled spouses or civil partners are fully exempt from IHT. However, if your spouse is domiciled outside the UK, your spouse's exemption is limited to the nil rate band of £325,000. Any transfers exceeding this amount could be chargeable to IHT.

This restriction can be lifted if your non-domiciled spouse becomes domiciled in the UK for IHT purposes, in which case the unlimited spouse exemption will apply. Unmarried partners, no matter how long-standing, have no spouse exemption.



## IHT on the family home

From April 2017, a family home allowance was phased in, enabling the family home to be passed on to children or grandchildren tax-free after death. This allowance is added to the existing nil rate band of £325,000 but is gradually withdrawn for estates worth more than £2 million.

Now fully phased in for deaths on or after 6 April 2020, the additional allowance adds a maximum of £175,000 to the existing nil rate band. Therefore, the total tax-free allowance available to the surviving spouse or partner from 2020/21 could be up to £1 million as any unused allowances are transferable.

There is also a relief in cases where individuals downsize or cease to own a home, leaving assets worth up to the equivalent of the new allowance to children or grandchildren.

## Special rules for Individual Savings Accounts

While Individual Savings Accounts (ISAs) remain in the estate for IHT purposes, the value of an ISA can be transferred to the surviving spouse or civil partner to invest in their own ISA without losing the advantage of remaining tax free for income tax and Capital Gains Tax purposes.

# Inheritance Tax on lifetime transfers

Gifts made during your lifetime are categorised for IHT purposes. There are three types of transfers.

## 1. Exempt transfers

This is where the value of the gift immediately falls outside the estate. These include:

Gift	Value limit
Gifts to a spouse domiciled in UK	Unlimited
Gifts to a spouse domiciled outside the UK	£325,000
Maintenance payments (to partners, ex-partners or dependent children)	Unlimited
Annual gift allowance for each donor (prior year available if unused)	£3,000
Small gifts to a gift recipient per tax year	£250 per recipient
Gifts to charity	Unlimited
Regular gifts out of income without reducing standard of living	Personal circumstances
Gifts to qualifying political parties	Unlimited
Gifts to an individual who is getting married or entering into a civil partnership	
By a parent	£5,000
By a grandparent	£2,500
By another person	£1,000

## 2. Chargeable transfers

Chargeable transfers are mainly gifts to certain Trusts. After deductions (the nil rate band and any other reliefs) the value of the transfer will be charged at the lifetime IHT rate of 20%.

If you die within seven years of making the gift, the value of the gift needs to be taken into account when calculating the IHT due and credit is given for the tax already paid. There is partial relief, called taper relief (see right), which could be available to reduce the tax on these gifts.

## 3. Potentially Exempt Transfers (PETs)

PETs are transfers which are neither exempt transfers

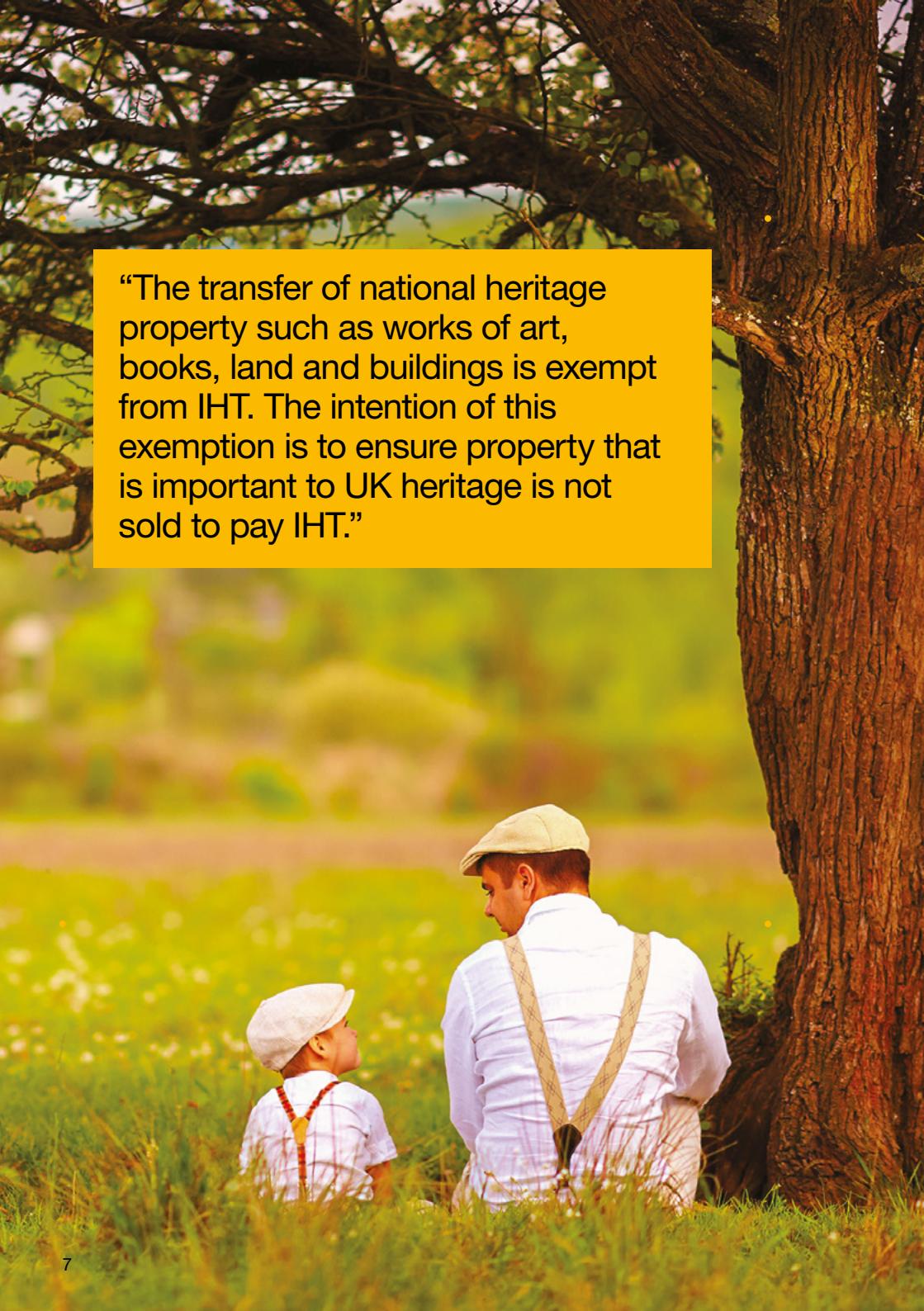
- nor chargeable transfers. This includes gifts which exceed the annual exemption of £3,000.

These gifts fall outside of your estate once you have survived the gift by seven years. If you die before the seven years have passed, the gift is added back to the estate when calculating IHT. Again, taper relief may be available to reduce the tax payable.

### Taper relief on gifts

Taper relief can reduce the amount of IHT on gifts made within seven years before death where:

- death occurs between three and seven years from the date of the gift
- the value of the gift, when added to any previous chargeable transfers in the seven years prior to the gift, exceeds the nil rate band in the year of death
- the reduction in IHT is determined by the number of years before death the gift is made.

A photograph of a man and a young boy standing in a field of tall grass and wildflowers. They are both wearing white shirts, white flat caps, and brown braces. They are looking up at a large, gnarled tree trunk on the right side of the frame. The background is a soft-focus view of rolling green hills under a clear sky.

“The transfer of national heritage property such as works of art, books, land and buildings is exempt from IHT. The intention of this exemption is to ensure property that is important to UK heritage is not sold to pay IHT.”

# Gifts with strings attached

Many people have tried to avoid IHT by giving assets away but still retaining a benefit from them. Two rules can stop this from being effective.

## **Gifts with reservation**

A gift with reservation is made where, following the gift, the donor still benefits from the transfer. For example, you gift your house to your child but you still live in it. The reservation means that the asset remains in the estate of the donor for IHT.

## **Pre-owned asset tax**

- This is an extension of the gift with reservation rule. It applies where a gift has been made but some benefit is still being enjoyed, although it is not classed as a gift with reservation and falls outside the IHT estate once the appropriate time has elapsed.

Less of a direct benefit is required to fall under this rule. For example, you give a sum of money to your child who, after three years, decides to acquire a house in which you will live. Even though there was no intention at the time of the gift, this tax charge is applicable. Although the gift remains outside the estate once you survive it by seven years, there is still a benefit being received from the gift when you move into the property so the pre-owned asset tax applies. In this case, the pre-owned asset tax is an income tax charge based on the rental value of the property.

# Reliefs

Various reliefs are available to reduce the amount of IHT an estate will pay, including a number of property exemptions.

## **Business Relief**

Business Relief (formally known as Business Property Relief or BPR) is available on the value of transfers of business property, providing that certain conditions are met. Relief can be available at 100% — meaning the value is free from IHT. Full relief is available on the transfer of:

- shares in unquoted trading companies
- an interest in trading partnerships
- a sole trader business.

Relief of 50% is available for assets which you own personally but are used in a personal trade. For example, if you own an office building in which your own personal company trades, 50% IHT relief will be available on the value of the office building.

For Business Relief to apply, you need to have owned the asset for at least two years.

If an asset is sold and a new one is acquired, it is possible in some cases to structure the transfer so that replacement Business Relief applies — in this case the two year period does not need to restart.



## **Agricultural Property Relief**

Agricultural Property Relief can apply to land, woodlands, farm buildings and certain farmhouses which accompany land. For this relief to apply you must have owned the property and used it for agriculture for two years ending on the date of the transfer, or owned it for a seven year period if the land is used for agriculture by another person. Relief is available at 100% on the agricultural value in most cases.

Again, where an agricultural asset is sold and a new one acquired, it can be possible in some cases to structure the transfer so that the two year period does not need to restart.

## **Heritage property exemption**

The transfer of national heritage property, such as works of art, books, land and buildings, is exempt from IHT. The intention of this exemption is to ensure property important to UK heritage is not sold to pay IHT. The property needs to go through an approval process in order to be exempt. To retain the exemption you need to meet certain conditions including maintaining the item, allowing public access and keeping the item in the UK.



## How Inheritance Tax is paid

The executors or legal personal representatives typically have six months from the end of the month of death to pay any IHT due. The executors cannot distribute to the beneficiaries until the IHT has been paid or until HMRC has agreed that no IHT liability arises.

IHT can be paid in instalments on certain types of assets including:

- land and buildings such as the deceased's house
- listed and unlisted shares where a controlling interest is held
- a business or an interest in a business.

Depending upon the type of asset, interest may be chargeable on instalments paid more than six months after the date of death.

“It is estimated that the number of people facing an Inheritance Tax bill has increased by 3,000 in the last tax year.”

# How we can help

Ensuring your estate is Inheritance Tax efficient is a sensitive subject, and as a result planning opportunities can be missed.

We preserve and maximise our clients' wealth, both for themselves and for future generations.

We advise on how and when wealth should be passed on, addressing common concerns such as IHT, asset protection and the education of the younger generation on the responsibility of inheritance.

## **Our services**

### **Calculations and returns**

- IHT calculations and IHT returns.
- Eligibility and claiming of reliefs.
- Valuation services.

### **Advisory and planning**

- Reviewing your estate to ensure it is IHT efficient.
- Advising on IHT efficient assets.
- Reviewing and designing wills to be tax efficient.
- Utilising annual gift exemptions.
- Using income to make gifts.
- Setting up a Trust.
- Maximising the nil rate band.





## Start the conversation

**Rebecca Durrant**

Manchester

[rebecca.durrant@crowe.co.uk](mailto:rebecca.durrant@crowe.co.uk)

+44 (0)161 214 7500

**Nick Latimer**

Cheltenham

[nick.latimer@crowe.co.uk](mailto:nick.latimer@crowe.co.uk)

+44 (0)1242 234421

**Simon Warne**

Kent

[simon.warne@crowe.co.uk](mailto:simon.warne@crowe.co.uk)

+44 (0)1622 767676

**Tom Elliott**

London

[tom.elliott@crowe.co.uk](mailto:tom.elliott@crowe.co.uk)

+44 (0)20 7842 7100

**Richard Bull**

Midlands

[richard.bull@crowe.co.uk](mailto:richard.bull@crowe.co.uk)

+44 (0)121 543 1900

**Mark Stemp**

Thames Valley

[mark.stemp@crowe.co.uk](mailto:mark.stemp@crowe.co.uk)

+44 (0)118 959 7222

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