INHERITANCE TAX

There is a lot of confusion surrounding Inheritance Tax (IHT). This guide aims to provide clear and concise information on the subject, and so inevitably many points have been covered only in brief or not at all.

In very simple terms, IHT applies to:

- your UK assets; and
- any non-UK assets if you have been UK resident for at least 10 out of the last 20 tax years (known as long-term resident).

Residence for any given year is determined by the Statutory Residence Test which, again in very simple terms, means present in the UK for at least 183 days of that year.

IHT is calculated in the event of your death on your *taxable* estate, which is essentially the combined value of:

- what you own as at the date of your death such as property/land, liquid assets (cash/shares/investments), business interests and personal possessions, whether owned in your sole name or your share of something owned jointly with someone else
- your unused pension funds as at the date of your death and associated death benefits that continue after your death (as opposed to regular pension payments that cease on death)
- any lifetime gifts you have made in the seven years before your death (although certain gifts are ignored, such as up to £3,000 in any one year, and regular gifts of any amount out of surplus income)
- any lifetime gifts you have *ever* made (whether in the seven years before your death or otherwise) if you continue to receive a benefit from the asset given away
- any assets held in trust where you are a beneficiary and the trustees *must* pay you the income (which therefore generally excludes any assets held in trust where you are a beneficiary but the trustees can decide whether or not to pay you any income or capital)

> The inclusion of your unused pension funds and associated death benefits within your taxable estate will not apply until 6 April 2027, and so any death occurring before that date will not include these if they have been 'nominated'. You should therefore seek advice from your financial adviser about nominating any pensions.

The value of any life insurance and/or Death-in-Service benefits need not form part of your taxable estate if they are 'written in trust'. You should therefore seek advice from your financial adviser about writing any such assets in trust.

If you do not have a financial adviser then let us know and we can recommend one to you.

Once the value of your taxable estate is known, if it passes to or in trust for:

- a spouse/civil partner
- charity

then there will be no IHT payable.

If your taxable estate does *not* pass to or in trust for a spouse/civil partner/charity then the rates of IHT will apply.

The rates of IHT are:

- 0% on **£2,500,000** of a farm/trading business (Agricultural Relief (AR)/Business Relief (BR))
- 0% on **£2,500,000** of a farm/trading business (Transferable Agricultural Relief (TAR)/Transferable Business Relief (TBR)) if you are widowed/a surviving civil partner (and your late spouse/civil partner did not use up their AR/BR)
  (and so the combined AR/BR/TAR/TBR totals £5,000,000)
- 0% on **one half of the value above £2,500,000** (or £5,000,000) of a farm/trading business (AR/BR)
- 0% on one half of the value of Alternative Investment Market (AIM) shares (BR)
- 0% on **£325,000** (Nil Rate Band (NRB))
- 0% on **£325,000** (Transferable Nil Rate Band (TNRB)) if you are widowed/a surviving civil partner (and your late spouse/civil partner did not use up their NRB)
  (and so the combined NRB/TNRB totals £650,000)
- 0% on **£175,000** (Residence Nil Rate Band (RNRB)) if you own a residence (or its proceeds of sale if sold during your lifetime) of at least this value which is inherited by your direct descendants ((step-)children/grandchildren)
- 0% on **£175,000** (Transferable Residence Nil Rate Band (TRNRB)) if you are widowed/a surviving civil partner (and your late spouse/civil partner did not use up their RNRB) *and* you own a residence (or its proceeds of sale if sold during your lifetime) of at least this value which is inherited by your direct descendants ((step-)children/grandchildren)
  (and so the combined RNRB/TRNRB totals £350,000; and the combined NRB/TNRB/RNRB/TRNRB totals £1,000,000)
- 40% on the balance (Standard Rate), or
- 36% on the balance (Reduced Rate) if at least 10% of your estate passes to or in trust for charity

In relation to the RNRB/TRNRB:

- the allowance is reduced by £1 for every £2 that the value of your taxable estate (less any lifetime gifts) exceeds the Taper Threshold of £2,000,000 so:
  - the RNRB is lost if that value exceeds £2,350,000
  - the combined RNRB/TRNRB is lost if that value exceeds £2,700,000
- the allowance can be lost if there is a gift in your Will into trust (even for the benefit of direct descendants) so:
  - *if, for example, there is a gift in your Will to a Discretionary Trust then this will result in the loss of the allowance* ***unless*** *the Trustees pay an amount equal to the allowance to direct descendants within two years of the date of your death*

From the above information, it can be noted that, *in general*:

- **A married couple/civil partners:**
    - need not pay any IHT on the death of the first of them; and
    - will pay IHT at the Standard Rate of 40% on the death of the last of them on any part of the taxable estate that does not pass to or in trust for charity and which exceeds £1,000,000

  (potentially reducing to £650,000 if the estate exceeds the Taper Threshold or there is no residence (of sufficient value) being inherited by direct descendants).
- **A couple that is not married/in a civil partnership:**
    - will pay IHT at the Standard Rate of 40% on the death of the first of them on any part of the taxable estate that does not pass to or in trust for charity and which exceeds £500,000

  (potentially reducing to £325,000 if the estate exceeds the Taper Threshold or there is no residence (of sufficient value) being inherited by direct descendants); and
    - will *also* pay IHT at the Standard Rate of 40% on the death of the last of them on any part of the taxable estate that does not pass to or in trust for charity and which exceeds £500,000

  (potentially reducing to £325,000 if the estate exceeds the Taper Threshold or there is no residence (of sufficient value) being inherited by direct descendants).
- **Someone who is single/divorced/a former civil partner:**
    - will pay IHT at the Standard Rate of 40% on death on any part of the taxable estate that does not pass to or in trust for charity and which exceeds £500,000

  (potentially reducing to £325,000 if the estate exceeds the Taper Threshold or there is no residence (of sufficient value) being inherited by direct descendants).
- **Someone who is widowed/a surviving civil partner:**
    - will pay IHT at the Standard Rate of 40% on death on any part of the taxable estate that does not pass to or in trust for charity and which exceeds £1,000,000

  (potentially reducing to £650,000 if the estate exceeds the Taper Threshold or there is no residence (of sufficient value) being inherited by direct descendants).

The information set out above is a massive simplification of an extremely complex area of law (and includes simplified terminology that is not used by HMRC) and so if you would like further advice in relation to IHT then let us know.

If consideration of the rules relating to IHT reveals that you have a potential IHT liability then you should note that:

- the liability will only arise in the event of your death, and so will be paid by your estate and not by you personally, and so
- any IHT planning undertaken by you in your lifetime will not benefit you personally but rather the beneficiaries of your estate

If you have a potential IHT liability *that you wish to reduce* then IHT planning might include, amongst other things, consideration of any or all of:

- **Life insurance:** to provide funds on death to meet the IHT liability, but also ensuring that your Attorneys have the ability to continue to pay the life policy premiums in the event of your mental incapacity
- **IHT-efficient investments:** including, but not limited to, pensions (taking account of anticipated changes to their treatment for IHT purposes)
- **Lifetime gifts:** taking account of, amongst other things, annual allowances; gifts out of surplus income; gifts of interests in property or business assets; the rules which prevent you from continuing to receive a benefit from the asset given away; the need to survive for seven years from the date of the gift; alerting you to any potential Capital Gains Tax liability that might arise as a result of the gift; and the option of Lifetime Trusts (depending on the circumstances of the intended recipients of the gifts)
- **Your Lasting Power of Attorney:** ensuring that your Attorneys have the authority to undertake IHT planning for you in the event of your mental incapacity
- **Your Will:** this will likely involve the use of a trust structure (the detail of which depends on your marital status) and/or multigenerational planning (that is, by you in your Will for the younger generation, or by the older generation in their Will for you)
- **Post-death planning:** in relation to any inheritance you have received within the last two years and/or any expected inheritance
- **Restructuring farms/businesses:** specialist advice that will likely include our Corporate & Commercial Department

If you would like further advice in relation to IHT planning – together with an indication of our charges for doing so – then let us know.

In addition to IHT being calculated in the event of your death, it is also calculated in certain trusts created by Will – such as a Discretionary Trust or some age-contingent gifts (but not a Flexible Life Interest Trust or Charitable Trust) – on the value of:

- The trust fund at each ten-year anniversary of the creation of the trust (the Anniversary Charge)
- Assets distributed out of the trust (the Exit Charge)

In very simple terms, the rate of IHT for the Anniversary Charge and the Exit Charge will be no more than 6%, but in many cases is less.

If you would like more detailed information on the taxation of trusts then please speak to the lawyer who is advising you.