

## **EXPLANATORY NOTES**

### **INHERITANCE TAX**

**Iain Wanstall**

Telephone: 01296 415700

e-mail: [iain@wanstallconsulting.co.uk](mailto:iain@wanstallconsulting.co.uk)  
[www.wanstallconsulting.co.uk](http://www.wanstallconsulting.co.uk)



Inheritance Tax (“IHT”) is mainly a “post death” tax, but it can also arise as a consequence of gifts made during lifetime.

IHT applies mainly where **value** is transferred, either by an individual during their lifetime or under their Will on death.

### **How does IHT operate?**

When someone dies, the value of their assets (their “estate”) is calculated – ie total assets less any liabilities. Their Nil Rate Band is then deducted. The Nil Rate Band (“NRB”) is the amount of an estate which is taxed at 0%, or is, in effect, “free of” IHT. (The NRB is currently £325,000 and is due to remain at this figure until 2026).

If the value of the estate exceeds the NRB, then the balance would normally be taxed at 40% for IHT.

### **The Transferable Allowance**

However, for married couples and civil partners, we have what is called the “transferable allowance” available for IHT.

Before 2008, for most married couples, IHT arose only when the second of them died. At that stage, only one NRB was available to offset against the total value of their joint estates. In 2008, the Government introduced the Transferable Allowance. This enables spouses and civil partners (or their executors) to claim the unused transferrable NRB from the first spouse’s or civil partner’s death for use by the estate of the survivor.

In summary, under current figures, provided the first spouse or civil partner left everything to, or for, the survivor (such as in a life interest trust which I would be very happy to discuss with you) – and had made no gifts to anyone else in the seven years before they died – the survivor’s estate should benefit from double their own NRB. Therefore, at present, a married couple or civil partners could have up to £650,000 “free of” IHT when they have both died. (£325,000 x 2). This could result in an IHT saving of up to £130,000 (£325,000 x 40%). (Please see our handout on the Transferrable Nil Rate Band Allowance for more information).

### **The Residence Nil Rate Band**

In 2017, the Government brought in another IHT allowance called the Residence Nil Rate Band (“RNRB”).

In summary, married couples and civil partners, provided they have children and have a property when they die which passes to their “direct descendants”, can have up to another £175,000 “free of” IHT. This means that married couples and civil partners could each have a combined NRB and RNRB of up to £500,000 – ie £325,000 + £175,000. As a couple, they could therefore potentially have a combined “IHT tax free” allowance of up to £1,000,000.

However, the RNRB is a complicated allowance and does not apply to all married couples or civil partners. Please let me know if you wish to discuss this further or have any questions.

## Lifetime Gifts

Depending on the overall value of the joint estate, even with the benefit of the transferrable allowance and the RNRB, an IHT liability may still be unavoidable when the second person dies. At that stage the value of the estate has to be calculated and the value of any gifts made in the previous seven years added to that figure. If the total value of the estate exceeds the joint transferable NRB and RNRB available, IHT is payable at the flat rate of 40% on the excess.

(NB if one party has English domicile for IHT purposes and one party does not, there may well be IHT implications. Again, please let me know if you wish to discuss this further or have any questions.)

There are various gifts (lifetime reliefs and exemptions) which can also be used to offset IHT. Some of the main ones are outlined here.

1. **Annual allowance.** Each adult can give away £3,000 in any one tax year. However, this is not a gift of £3,000 for each recipient – there is a total allowance available of £3,000. This annual allowance can, if unused, be carried forward one tax year to give an annual exemption of £6,000.
2. **Small gift allowance.** Gifts of up to £250 can be made to individuals every tax year.
3. **Gifts to spouses and civil partners.** Lifetime gifts to a spouse or civil partner are exempt from IHT.
4. **Regular payments out of income.** Regular expenditures which are made out of surplus disposable income and are made for somebody else's benefit, and which do not affect the donor's standard of living, can be exempt from IHT. (The "donor" is the person who made the gift).
5. **Charities.** Gifts made to UK registered charities, whether in lifetime or in a Will, are exempt from IHT. Also, if more than 10% of an estate is left to charities in a Will, the IHT rate of 40% can be reduced to 36%.
6. **Potentially Exempt Transfers ("PETs").** PETs are gifts made which exceed the annual allowance. If the donor currently survives the date of a gift by seven years, the value of the gift will not be taken into account in their estate for IHT purposes. However, if the donor dies within seven years of making the gift there will be an impact on the IHT position. (This is a very useful, but often misquoted, allowance and advice should be taken on such gifts. Again, please let me know if you wish to discuss this further, or if you have any questions.)
7. **Gifts on marriage or civil partnership.** Gifts of up to £5,000 can be made to your own children in consideration of their marriage or civil partnership, but these gifts must be made prior to the wedding or civil partnership. Similarly, a gift of £2,500 can be made to your grandchildren and £1,000 for any other party, such as the person marrying your child or grandchild.

## Gifts with Reservation

One of the most common misconceptions about IHT concerns the anti-avoidance provisions relating to gifts with reservation. If a lifetime gift is made in such a way that the donor still retains a benefit from the assets given away, HM Revenue & Customs can disregard the gift entirely, with the value of the property being added to the donor's estate for IHT. For example, giving away a house but

continuing to live there without paying full market rent, would fail as a gift with the whole value of the house forming part of the estate, even if the gift had been made more than 7 years before the donor died.

### **Business and Agricultural Property Relief**

There are currently generous reliefs from IHT available if someone owns certain types of business and / or business assets, and for assets held for agricultural purposes. Specialist advice should be taken to maximise the use of these reliefs wherever possible and please let me know if you wish to discuss this further or have any questions.

This handout is for information purposes only to cover the basic principles and should not be relied upon. If you would like to discuss IHT, gifts or IHT related matters, please contact me and I will be very happy to discuss this with you further.

*This booklet deals in general terms with a complex subject. While we believe the contents to be correct, they should not be regarded as sufficiently full, accurate or precise so as to apply to any particular situation. You must always seek legal advice concerning any situations referred to in this booklet and Wanstall Consulting or its author can accept no responsibility for any loss suffered by any person as a result of acting in reliance upon the contents of this booklet.*

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