

Inheritance Tax Reliefs

If the gift is of a special type of asset and the necessary conditions are met, relief may apply to reduce the amount of IHT payable, sometimes to nil. The main reliefs are as follows:

- Agricultural property relief: available for farmland and farm buildings anywhere in the European Economic Area (including the UK). Relief is given at either 50% or 100%, depending on the circumstances.
- Business property relief: available for certain business interests and qualifying company shares located anywhere in the world. Relief is given at either 50% or 100%, depending on the circumstances.

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Inheritance Tax

a guide to Inheritance Tax



When is Inheritance Tax Charged?

Inheritance Tax (IHT) is primarily a charge on your assets on death, including your share of assets jointly held with another person. However, lifetime gifts made within seven years prior to your death can also be brought back into charge.

IHT is also charged where an asset appears to have been given away, but where you in fact retain the use of (or a significant benefit in) the asset given. For example, where you give your home (in which you continue to live) to your children and do not pay them full market rent for your occupation.

What are the nil rate bands?

The nil rate band and residence nil rate band are amounts which are chargeable to IHT at 0%. The basic nil rate band is currently £325,000. There is also an extra nil rate band (called the residence nil rate band) of between £100,000 and £175,000 (depending on whether the death occurred in the tax year 2017/18, 2018/19, 2019/20 or 2020/21) if the family home is inherited by children or grandchildren.

If you are married, your surviving spouse, or civil partner can “inherit” the unused portion of your nil rate band or residence nil rate band. When a claim is made, this increases the surviving spouse or civil partner’s nil rate band and residence nil rate band on a percentage basis (and not simply by the amount of your unused nil rate band and residence nil rate band).

Example

Mr X died a number of years before Mrs X. On death he had an available nil rate band of £200,000. He left £50,000 to his children and the remainder of his estate (including his half of the family home) to Mrs X (who owns the other half of the family home).

The spouse exemption applied to the gift to Mrs X, so it did not use up any of Mr X’s nil rate band. The £50,000 gift to his children fell within his available nil rate band and was therefore free of IHT.

However, 75% of Mr X’s available nil rate band was unused. When Mrs X dies her executors can claim to transfer the unused percentage of Mr X’s basic nil rate band, which would otherwise be wasted.

Mrs X did not use up any of her basic nil rate band of £325,000. She leaves the family home to her children. Her executors can claim a transferable nil rate band in relation to her husband which is worth 75% of her available nil rate band so that £325,000 is increased by a further 75%.

Mr X could not use up any of his residence nil rate band because he left his share of the home to his wife rather than his children or grandchildren. Therefore, Mr X’s unused residence nil rate band can be transferred over to be used by Mrs X’s executors when they are calculating how much inheritance tax they have to pay.

Mrs X’s residence nil rate band can be increased by 100% taking into account Mr X’s unused residence nil rate band. The combined basic nil rate bands available to set against Mrs X’s estate will be £568,750 (that is, her own nil rate band of £325,000, plus an additional 75% of £243,750).

In addition, if Mrs X dies in the tax year 2018/2019, Mrs X’s executors can also claim residence nil rate band of £125,000 for Mrs X and carry forward a further 100% of residence nil rate band which was unused by Mr X when he died. The total residence nil rate band is, therefore, £250,000.

In total, £818,750 of Mrs X’s estate is charged to inheritance tax at 0% with the remainder being charged at the rate of 40%.

What is the rate of Inheritance Tax on death?

- The nil rate band is charged at 0%.
- The balance is charged at 40%. However, the rate of IHT is reduced from 40% to 36% for individuals who leave 10% or more of their net estate to charity.

There are, however, various exclusions, exemptions and reliefs which can reduce the amount of IHT payable.

Inheritance Tax Exemptions

Certain gifts are exempt from IHT and do not use up your nil rate band. Briefly, the main exemptions are as follows:

- Gifts to your spouse or civil partner.
- Gifts to charities established in the UK, any other EU country, Norway or Iceland.

Additional exemptions are also available for lifetime gifts, if none of the above exemptions apply. They are as follows:

- Normal expenditure out of income.
- Small gifts: up to £250 to any one individual per tax year is exempt (the exemption is only available if the gift does not exceed £250).
- Wedding or civil partnership gifts: each parent may give the couple £5,000; grandparents and great grandparents may give £2,500; others may give £1,000.
- Annual exemption: £3,000 a year.
- Potentially exempt transfers: outright gifts of any amount become fully exempt if you survive for seven years.

The “normal expenditure out of income” exemption is applied first and the “annual” exemption is applied last, after the application of any other available exemption.