

“ Plain speaking legal advice ”

Inheritance Tax Reliefs and Exemptions

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1 **Spouses and Civil Partnerships**

Gifts to and transfers between Spouses or Civil Partners are wholly exempt.

2 **Gifts**

Gifts to Charities and Political Parties are wholly exempt.

3 **Nil Rate Band**

The first £325,000 of any Gifts that are chargeable to tax are exempt from Inheritance Tax. This is the so called Nil Rate Band and it is increased in line with inflation each year. In the case of a married couple or a same sex couple a Civil Partnership there may be two Nil Rate Bands available when the second spouse or partner dies by virtue of what is called “the Transferable Nil Rate Band”

4 **Potential Exempt Transfers**

These are commonly called PETS, and are exempt from Inheritance Tax provided that the giver lives for more than seven years after the gift. To qualify as a PET the gift must either be an outright and unconditional gift or a gift to a Vulnerable person’s trust. Where you fail to survive a PET by seven years Inheritance Tax may become payable by the recipient of the gift or the amount of tax payable on your estate may increase. There is a limited form of taper relief for gifts made less than seven years before death. This relief is widely misunderstood and makes pathetically little difference to the tax that is payable.

5 **Chargeable Transfers**

A lifetime gift to a Trust is a Chargeable Transfer and gives rise to a potential immediate charge to Inheritance Tax. The Tax is payable at a rate of up to 20% in so far as the giver’s total gifts exceed the Nil Rate Band. After seven years the gift falls out of the giver’s IHT record but if the giver dies within seven years of the gift the rate of tax is increased to 40%.

6 **Small Gifts**

It is possible to make any number of Gifts of £250.00 to any number of different individuals. However this exemption cannot normally be combined with one of the other exemptions.

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7 **Annual Exemption**

This is £3,000.00 per annum, and has remained unchanged for many years. To avoid confusion it should be made clear that this means that an individual can, during the tax year, give up to £3,000.00 to another individual or individuals without any liability to Inheritance Tax, either immediately or in the future. It is not possible to make multiple gifts of £3,000.00 but in a marriage situation both the partners have an annual exemption.

8 **“Normal Expenditure Out of Income”**

The principal aim behind this is to cover such things as normal Christmas and Birthday presents and life assurance premiums. However for somebody with a large income that they are not fully utilising this exemption can offer the opportunity to make substantial Gifts that are exempt from Inheritance Tax. As such this can sometimes be a very useful exemption, particularly for an elderly person whose expenditure requirements are going down and who is finding that surplus income is building up in a bank account and simply increasing the potential problem in relation to future Inheritance Tax.

9 **Business and Agricultural Property**

There are wide ranges of exemptions relating to businesses, business assets, farming and farming assets. This extends to unquoted shares.

10 **Shared Property**

Where a tax payer occupies a house with another person it is possible to give a Share in the property to the other person. This can escape the usual Gifts with a Reservation of Benefit rules (see below), but must be used carefully so as not to fall outside the scope of the rules.

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A FEW REMINDERS OF THE PITFALLS TO BE AVOIDED:

◆ **CAPITAL GAINS TAX**

If one seeks to make Potentially Exempt Transfers with a view to avoiding Inheritance Tax one must remember that a Gift is a disposal for the purposes of Capital Gains Tax, and accordingly one may escape one tax only to pay another. The situation is made much worse if, having made a Potential Exempt Transfer, paid Capital Gains Tax, you then fail to live the requisite seven years. In that case Inheritance Tax is also paid and one has in effect paid two taxes and been subject to a “Double Whammy”.

◆ **GIFTS WITH A RESERVATION OF BENEFIT**

A Gift of property in which the donor continues to retain some sort of benefit is called a Gift with a Reservation of Benefit – such Gifts are valid in legal terms and for the purposes of Capital Gains Tax, but are not valid for the purposes of Inheritance Tax and will not count until a Potentially Exempt Transfer until the Reservation ceases. The classic example of this is a gift of your house to a child while you continue to live in the property.

◆ **THE TIMING AND ORDER OF LARGE GIFTS**

If you are able to afford to make large gifts then the order in which they are made could effect the amount of tax paid either on the making of the gifts or if you fail to live for 7 years after the last gift. This is particularly important where you are making Potential Exempt Transfers i.e. outright gifts, and Chargeable transfers i.e. gifts into trust.

◆ **NOT ALL TRUSTS SAVE TAX**

There is a wide spread belief that the use of Trusts saves Inheritance Tax. It is certainly true that Trusts are frequently used in Inheritance Tax saving, but only certain types of Trust can achieve tax saving. The most common, is a simple Life Interest Trust, where one particular person is entitled to benefit from property during his or her life. Generally speaking these trusts are Inheritance Tax Neutral with the value of the Trust Property is added together with the value of the Beneficiary’s property for the purposes of assessing Inheritance Tax.

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- ◆ **DEPRECIATING ASSETS**
Tax is chargeable on the value given away. Try not to give away depreciating assets rather give away those that do or have the capacity to appreciate.

- ◆ **LIMITS TO BUSINESS RELIEF**
Although many businesses are exempt from Inheritance Tax it should be noted that those relating to the investment in land and securities are not exempt from Inheritance Tax. These are the tax lepers of the tax system that tend to get caught by all the tax traps within the UK tax system. Another trap for the unwary is to give away business assets to someone who within 7 years sells those assets and pockets the proceeds, in such a case the gift is treated as a Potentially Exempt Transfers of the proceeds of sale and is not exempt from IHT unless the giver lives for more than 7 years.

- ◆ **PROOF**
The Revenue may choose to argue with claims for exemptions – do your homework and leave your executors with all the necessary ammunition.

SOME FINAL REMINDERS:

- ❖ Husbands and Wives should equalise estates
- ❖ Avoid substantial build up of Capital Gains as the prospect of paying Capital Gains Tax can inhibit Inheritance Tax planning.

NOTE. The information contained in this leaflet is believed to be correct at the time of writing. No action should be taken in reliance on the information contained in this paper without obtaining professional advice.

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