Inheritance Tax Reliefs and Exemptions

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The following is a list and brief description of the principal reliefs and exemptions from Inheritance Tax. It is not an exhaustive list and should not be relied upon without first obtaining professional advice.

1. Spouses and Civil Partners

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

2. Charities

Gifts to UK Charities and Political Parties are wholly exempt.

3. Nil Rate Band

The first £325,000 of any gifts that are chargeable to tax is exempt from Inheritance Tax. This is the so called Nil Rate Band and this should be increased from time to time. However it has been frozen since 2009 and is not expected to increase in the next few years.

An additional Residential Nil Rate Band rising to £175,000 is expected to be introduced between 2017 & 2021.

4. Transferable Nil Rate Band

In the case of a married couple or a Civil Partnership there may be two Nil Rate Bands available when the second spouse or partner dies. This arises when the first spouse bequeathed some or all of his/her estate to the surviving spouse. Certain types of trust for the surviving spouse are also eligible for this sort of transfer. Where the first spouse has left part of their estate to their spouse and part to taxable beneficiaries then only a proportion of the Nil Rate Band is transferred. In most circumstances there can only be a maximum of two Nil Rate Bands, but occasionally if one of the spouses is already a widow or widower, it may be possible to have a third Nil Rate Band.

5. Chargeable Transfers

A lifetime gift to a Trust is a Chargeable Transfer and potentially gives rise to a an immediate charge to Inheritance Tax. The Tax is payable at a rate of 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 he or she 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 to any number of different individuals. However this exemption cannot normally be combined with one of the other exemptions.

7. Annual Exemption

This is £3,000 per annum, and has remained unchanged for many years. To avoid confusion, it should be made clear that this means than an individual can, during the tax year, give up to £3,000 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 but with couples both partners have an annual exemption.

8. "Regular Expenditure Out of Excess 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. In essence, 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 of 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 Reservation of Benefit rules (see below), but must be used carefully so as not to fall outside the scope of the rules.

11. Maintenance of a Dependant

Gifts to provide maintenance of another person are exempt from tax. Most commonly this covers a parent providing for children's education but sometimes the exemption can be put to good use by grandparents assisting their children in the education of grandchildren.

A FEW REMINDERS OF PITFALLS TO BE AVOIDED:

- **Capital Gains Tax**

If someone seeks to make Potentially Exempt Transfers with a view to avoiding Inheritance Tax , they must remember that a gift is a disposal for the purpose of Capital Gains Tax, and accordingly they may escape one tax only to pay another. The situation is made much worse if, having made a Potential Exempt Transfer and paid capital Gains Tax, you then fail to

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live the requisite seven years. In that case Inheritance Tax is also paid. One has in effect paid two taxes on the same property 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, but for the purposes of Inheritance Tax, they will not count as a Potentially Exempt Transfer until the Reservation ceases. The classic example of this is a gift of your house to a child who is not living with you 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 affect the amount of tax paid, whether 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 Potentially 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 as part of a strategy for saving Inheritance Tax. However, many trusts, particularly those created in Wills, may function primarily to protect an estate while being Inheritance Tax neutral.

- **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 investment in land and securities are not exempt from Inheritance Tax. These are the tax lepers of the tax system that tend 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 Transfer 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 each use their allowances; equalising estates may help with this.
- Try to avoid substantial accumulations of Capital Gains as the prospect of paying capital Gains Tax can inhibit Tax planning, but do not forget that Capital Gains Tax at a maximum of 28% is a lot less than Inheritance Tax at 40%.

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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