

Inheritance Tax (IHT)



The IHT legislation is highly complex. Necessarily, what follows is a very simplified explanation of IHT. Depending on the extent of your assets and complexity of your situation, in some circumstances it might be advisable to seek specialist tax advice.

If the net value of your estate exceeds the applicable allowances then, subject to any reliefs or exceptions, the excess is currently taxed at 40%. Usually the most important exception is the spouse exception (which applies only to married couples and civil partners). Any gift to a spouse is free of tax. For that reason, the application of IHT on the death of the first spouse is not generally a concern. The difficulties usually arise on the death of the survivor.

Every person has a personal tax allowance (Nil Rate Band or NRB) of £325,000. In addition to the NRB, you may qualify for a rather complicated property specific allowance known as the Residential Nil Rate Band (RNRB) as to which see below.

A significant tax benefit for married couples and civil partners is that the NRB and RNRB are transferable to the surviving spouse in so far as either of them has not been fully used on the first death. Gifts to a spouse do not utilise any of the allowance. As a result, married couples are generally able to pass on tax free twice as much as single persons. As of April 2020, the survivor of a married couple can pass on up to £1,000,000 tax free, whilst a single person can pass on only up to half of that amount before paying tax.

The NRB has not increased for a number of years. The RNRB was intended to increase with inflation from April 2021, but has now been frozen until 2026.

RNRB

The RNRB allows further IHT relief where you leave a property to your direct descendants. But note the small print:

- ❖ It only applies up to the net value of the property less any mortgage.
- ❖ It can only be applied to one property. If you have more than one property (including property abroad) your executors decide which property to claim relief against provided it is one that you have resided in at some point (regardless of how long).
- ❖ The property must be left to direct descendants. This will include grandchildren, spouses of direct descendants (even if widowed), anyone who was your step-child at any time, adopted children, children you have fostered at any time, someone for whom you were appointed guardian.
- ❖ You are only allowed so much wealth before the RNRB is taken away from you. There is a wealth cap, above which the RNRB is tapered off until there is nothing left. For every £2 over the cap, £1 of RNRB is deducted. The cap applies where the net value of your estate exceeds £2 million. The value of your estate only has to be a few hundred thousand in excess of this amount for the entire RNRB to be tapered away. This was also intended to start increasing in line with inflation from April 2021, but has now been frozen until 2026.

Potentially Exempt Transfers (PETs)

Any gifts you make during your lifetime may be brought back into account in determining the amount of IHT that is payable on death. This does not apply to exempt gifts such as gifts to charity, your spouse and other small exemptions.

Ordinarily a PET will be free of IHT if made at least seven years before you die. From four years after the gift is made an increasing amount of taper relief is applied until the gift is fully exempt. Within four years it can be brought into account in full. However, tax will only be payable if the value of your estate plus the gift exceed the available Nil Rate Band allowances.