A Guide to Inheritance Tax

About
Inheritance Tax

Inheritance Tax, sometimes referred to as a Voluntary Tax, is payable on your estate when you die. It is the responsibility of your Executors to calculate and pay the inheritance tax. If Inheritance tax is applicable, it must be reported and paid within six months of death otherwise HMRC will apply penalties and interest.

If you are UK resident and UK Domicile, inheritance tax is payable to HMRC on your worldwide Assets. In you are non-UK Domicile, this guide does not apply and you should seek specialist tax advice.

In this guide we explain the main inheritance tax allowances and exemptions and explore ways of mitigating the tax so you are able to make an informed choice.

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Allowances and Exemptions

1. Nil Rate Band

Each individual has a tax-free allowance of £325,000. This means that if the value of your estate is below this threshold, no inheritance tax is due.

2. Residence Nil Rate Band

If you pass your home to your children or grandchildren, you can benefit from an additional allowance of up to £175,000. This can increase your total tax-free threshold to £500,000. This allowance is available if your estate is valued under £2mn. Once your estate reaches £2mn, you will lose £1 for every £2 the value is over the £2mn. Once your estate reaches £2,350,000, the residence nil rate band is not available to claim.

3. Spouse or Civil Partner Exemption

Anything left to your spouse or civil partner is exempt from inheritance tax, regardless of the amount.

4. Charity Exemption

Gifts to charities are exempt and if you leave 10% or more of your estate to charity, the inheritance tax rate on the remaining estate can be reduced from 40% to 36%.

5. Business Relief

Certain business assets can be passed on free of inheritance tax or with a reduced bill. Business Relief (BR) is a valuable inheritance tax relief in the UK designed to help business owners pass on their business assets without incurring significant tax liabilities. Here are the key points:

- **Purpose:** Business Relief reduces the value of a business or its assets when calculating inheritance tax, allowing the business to continue operating without being burdened by a large tax bill
- **Qualifying Assets:** BR can apply to various business assets, including:
    - Property and buildings used in the business
    - Unlisted shares (e.g., shares in private companies)
    - Machinery used in the business

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- **Relief Rates:** You can get either 50% or 100% relief on qualifying business assets:
  - **100% Relief:** Applies to unlisted shares and sole trader or partnership interests.
  - **50% Relief**: Applies to assets used in the business but not owned by the business, such as property or machinery
- **Claiming Relief:** Executors or administrators of the estate can claim BR when valuing the estate. This involves filling out specific forms (IHT400 and IHT413) and using the market value of the business or assets
- **Changes and Planning:** Recent changes announced in the 2024 Autumn Budget will cap the amount of relief available. From April 2026, the first £1 million of qualifying assets will be exempt from inheritance tax, and any excess will attract 50% relief

6. Agricultural Relief

If your estate includes a farm or woodland, you may qualify for relief on these assets.

7. Life Policies

If the life policies you have are written in trust, it means the sum assured is paid directly to your chosen beneficiaries and the value does not fall into your estate for inheritance tax.

8. Transferring Unused Allowances

If your estate is worth less than your threshold, any unused allowance can be transferred to your spouse or civil partner, potentially doubling their tax-free threshold.

9. Gifts

Gifts given during your lifetime may be subject to inheritance tax if you die within 7 years of giving them. However, taper relief can reduce the tax on these gifts depending on how long before your death they were given.

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Allowances and Exemptions

In the UK, there are specific annual gifting allowances that allow you to give away a certain amount of money or assets each year without them being subject to inheritance tax. Here are the key allowances:

- **9.1 Annual Exemption:** You can give away up to £3,000 worth of gifts each tax year without them being added to the value of your estate. This is known as your annual exemption. If you don't use your full £3,000 allowance in one year, you can carry it forward to the next year, but only for one year
- **9.2 Small Gift Allowance:** You can give as many gifts of up to £250 per person as you want each tax year, as long as you haven't used another allowance on the same person
- **9.3 Wedding or Civil Partnership Gifts:** You can give tax-free gifts to someone getting married or entering a civil partnership. The amount you can give depends on your relationship to the person:
  - £5,000 to a child
  - £2,500 to a grandchild or great-grandchild
  - £1,000 to anyone else
- **9.4 Regular Gifts from Income:** You can make regular gifts from your income, as long as they don't affect your standard of living. These gifts are exempt from inheritance tax if they are part of your normal expenditure

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10. What Can I Do?

10.1 Spend it

We are conditioned to save money but there comes a time when spending money will reduce the inheritance tax payable on your estate but also improve your quality of time by taking more trips and holidays, self-care, employing a gardener, cleaner or decorator rather than doing everything yourself and choosing taxis over public transport.

10.2 Give it away

(Use all your allowances highlighted above)

10.3 Financial Advice

A qualified Financial Adviser can look at investments and trusts which are more tax efficient or discuss whether Equity Release is an option for you.

10.4 Life Policies

Make sure they are written in trust so that they do not form part of your estate.

10.5 If you are co-habiting

Consider marriage or civil partnership as anything you leave to a spouse/civil partner is exempt.

10.6 Plan for it

A whole of life policy can be a strategic tool for managing inheritance tax (IHT) liabilities. Here's how it works:

- **10.6.1 Guaranteed Payout:** A whole of life policy provides a guaranteed payout upon death, regardless of when it occurs. This ensures that there are funds available to cover the IHT bill
- **10.6.2 Placed in Trust:** To maximise the benefit, the policy is often written in trust. This means the payout is not considered part of your estate and is therefore not subject to IHT. The funds go directly to the beneficiaries, who can use them to pay the IHT due on the estate
- **10.6.3 Covering IHT Liabilities:** The payout from the policy can be used to cover the IHT liabilities, preventing the need to sell assets or property to pay the tax. This can be particularly useful for estates with illiquid assets, such as property or business interests

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10. What Can I Do?

10.7 Debts

Debts will be deducted rom the value of your estate so having a mortgage is not always a bad thing, but always take professional advice on your circumstances.

We hope you have found this guide helpful and we would be delighted to discuss your own situation with you. Please contact the office to book a consultation meeting.

01635 33733
info@heritageestateplanning.co.uk
heritageestateplanning.co.uk

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