



# INHERITANCE TAX

## HANDY GUIDE



## What is Inheritance Tax (IHT)?

Conceptually IHT is a tax on the transfer of wealth from one person to another. It is most commonly encountered when one person dies, leaving their assets (“estate”) to another person or people. However, lifetime gifts also have IHT consequences.

- Essentially every individual has a nil rate band of £325,000 – this is the value of your estate that you can leave to anyone before there is any IHT to pay.

### Will my estate be exposed to Inheritance Tax when I die?

It depends. The principal factors are:

- What is the value of your estate at the time of your death?
- Did you make any lifetime gifts within seven years of death, and, if so, what was the value of the gift and who received it?
- Do any of your assets have relief from, or are they exempt from, IHT at the time of your death?
- Who are you leaving your estate to? Are any of the beneficiaries “exempt” from IHT?
- How much “nil rate band” and “residence nil rate band” do you have available at the time of your death?

Very broadly if you have made no substantial gifts in the last seven years and your estate is worth less than £325,000 (for individuals) or £650,000 (for married couples combined) it is unlikely that there will be an IHT charge at the time of your death. If the value of your estate is worth less than £500,000 (for individuals) or £1,000,000 (for married couples combined), again it is unlikely that there will be an IHT charge at the time of your death (after 2021) if you qualify for the residence nil rate band.

## What is the rate of Inheritance Tax?

Generally, it is 40%.

### What is the “nil rate band”?

Essentially every individual has a nil rate band of £325,000 – this is the value of your estate that you can leave to anyone before there is any IHT to pay. It is called a nil rate band because assets up to that value are taxed at 0%.

If one spouse doesn’t use, or fully use, their nil rate band at the time of their death (because, for example, the value of their estate is less than the nil rate band, or all of their assets are passing to the surviving spouse who is an “exempt” beneficiary”) then the unused proportion can be transferred to the surviving spouse and is available at the time of their death. This is known as the “transferable nil rate band”.

### What is the “residence nil rate band”?

In very broad terms this is an extension to the nil rate band and is available to homeowners who leave their house to their “direct descendants” (children, grandchildren etc). It is being phased in over time and by 2021 will provide an additional £125,000 of nil rate band. However, the extension starts to be withdrawn if your estate exceeds £2,000,000 at the time of death.



## Who are “exempt beneficiaries”?

The two main types of exempt beneficiaries are (i) spouses and (ii) charities.

- Any transfer of wealth, during lifetime or on death, from a person to their spouse is exempt from IHT. (There is an exception to this where the recipient spouse is not “domiciled” in the UK, in which case the spouse exemption is capped at £325,000).
- Any transfer of wealth, during lifetime or on death, to a UK charity is exempt from IHT. If you leave at least 10% of your estate to a UK charity on death, if any IHT is payable on the remainder of your estate it is paid at 36% (instead of 40%).

## What types of assets are exempt from IHT?

There are two main classes of assets that are exempt (or partially exempt) from (or, technically, have relief from) IHT.

- Interests in businesses that have been owned by you for more than two years and qualify for “business property relief”. This may include interests in sole-trader businesses, interests in trading partnerships and unlisted shares in trading companies. Investment businesses do not qualify.
- Interests in agricultural property that have been owned and occupied for the purposes of agriculture by you for more than two years, or have been owned by you but occupied by someone else for the purposes of agriculture for more than seven years, that qualify for “agricultural property relief”. This relief only extends to the agricultural value of the agricultural property, so if the market value exceeds the agricultural value, APR does not provide relief for the excess value.

## Are all of my assets exposed to IHT?

Some assets are not technically part of your estate and although they may provide valuable payments on death, they are not usually subject to IHT. These may include life assurance payouts on your death, pension death benefits and death-in-service payments through your employment.



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## Can I plan my affairs to reduce my exposure to IHT?

Yes, IHT planning is lawful and the legislation sets out a number of reliefs and exemptions that can help to mitigate the tax liability. There are many and varied anti-avoidance rules that seek to ensure that the reliefs and exemptions are not used inappropriately. The traditional methods of IHT planning are:

- Lifetime giving to reduce the estate on death. Many gifts can be made without incurring any IHT consequences providing that you survive the gift by seven years.
- For married couples, making use of the spouse exemption to prevent any IHT being payable on the death of the first of a married couple to die.
- Taking out life assurance to provide funds on death to pay or help towards paying the IHT liability.
- Investing in various financial products that provide a form of investment but also seek to secure an IHT benefit. The main examples are discounted gift trusts, loan trusts and flexible reversionary trusts.
- Investing in assets that have relief from IHT by virtue of business property relief and/or agricultural property relief.
- Considering the use of deeds of variation and other methods to reduce an IHT bill even after a person has died.

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## What if I do not live in the UK or have assets in other countries?

Individuals who are domiciled in the UK are subject to UK IHT on their worldwide assets. It is UK domicile, rather than residence, that triggers UK IHT. Domicile is more a concept of the country you regard as your home, and is not necessarily the country you live in. There are also rules that deem you to be domiciled in the UK based on your pattern of residence.

This guide provides a broad overview of IHT which is, by its nature, a complex area. This guide does not provide advice and should not be relied upon on its own. Individual circumstances require independent professional advice and we would, of course, be pleased to provide this.

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