INHERITANCE TAX RATES AND RULES - INFORMATION FOR CLIENTS

Walsh West Certified Chartered Accountants 2021

This article explains how Inheritance Tax (IHT) works in the United Kingdom.

It is a death duty paid to HMRC if the value of a person's estate is worth more than the threshold when they die.

DEATH DUTIES: For Inheritance Tax purposes, the estate includes money, property, and personal possessions.

As a rule, there would be no Inheritance Tax liability if (either):

- After valuing the estate of someone who's died, its monetary worth is below the current threshold of £325,000.
- The total value of the estate goes to the spouse (or civil partner), a charity, or a community amateur sports club (CASC).

***Note**: It still needs reporting to HM Revenue and Customs (HMRC) even if the value of the estate is less than the threshold.* In some cases, you can increase the Inheritance Tax threshold to £500,000. It would mean 'passing on a home' to your children or your grandchildren. The same rule applies to adopted, fostered, and stepchildren.

You can also add any of your unused threshold to that of your partners after your death, if the total value of your estate is below the threshold. Thus, your spouse (or a civil partner) can increase their Inheritance Tax limit up to £1,000,000.

Inheritance Tax Rates 2021

The standard Inheritance Tax rate in the United Kingdom is 40%. Even so, the death duty (40% tax charge) only relates to the part of an estate that is higher than the threshold.

Example:

Let's assume that your estate is worth £400,000 and your tax-free threshold is £325,000. The amount of Inheritance Tax charged on the estate would be 40% of £75,000 (£400,000 minus £325,000).

There would be a way for the estate to pay Inheritance Tax at a reduced rate of 36% on some of the assets. You would need to leave 10% or more of the 'net value' of your will to charity.

Inheritance Tax Reliefs and Exemptions

Giving certain gifts while you are still living can get taxed after you die. It would depend on when you gave away the gift. But the application of 'taper relief' could mean it gets charged at a rate less than 40% (see below).

Read Inheritance Tax planning ideas for extra details on other reliefs and exemptions. Likewise, there is a way to get Business Relief for Inheritance Tax. It allows the passing of certain assets to avoid paying Inheritance Tax or reducing the bill.

Estates with Farms or Woodlands

The Inheritance Tax and probate helpline provides further information about Agricultural Relief. It might apply if your estate includes a farm or woodland.
Inheritance Tax.

Who Makes the Payment to HMRC?

Inheritance Tax payments come from funds in the estate of the deceased person. The death duties get paid to HM Revenue and Customs (HMRC).

***Note**: The 'executor' would deal with a deceased person's estate if a Last Will and Testament exists.*

People who inherit an estate are the beneficiaries. As a rule, they would not pay tax on inherited money, property, and shares. But there could be some related taxes to pay. A typical example would include rental income from a house left to the beneficiaries in a will.

Inheritance Tax might also be due from the people who receive gifts. But it would only be liable if you die within seven (7) years of giving away more than £325,000.

Inheritance Tax Passing on a Home

Inheritance Tax rules allow you to pass a home to your spouse (husband or wife) or your civil partner when you die. In this case, there would be no death duty to pay.

But, leaving your home to another person (such as in your will) means it would count towards the value of your estate.

Owning your own home (or a share in it) gives you the option to increase your tax-free threshold to £500,000. It only works if:

- You leave the property to your children or grandchildren (includes adopted, foster, or stepchildren).
- The total value of your estate is less than £2 million.

Giving Away a Home before Death

As a rule, Inheritance Tax rates do not apply if you move out of the home and live for at least another seven (7) years. But, the only way to continue living in your property after giving it away, is to:

- Make rental payments to the new property owner at the going rate (i.e., similar rental homes in the area).
- Pay for your share of the utility bills.
- Live in the property for at least seven (7) years.

There would be no need to pay rent to the new owners of the property if these apply (both):

- You gave away only a part of your property.
- The new homeowners also live at the same property.

Dying within 7 Years

The rules on Inheritance Tax change if you were to die within the seven-year period. The rule applies no matter whether you give it all away or only part of it. In this case, HMRC would treat the home as a gift and so the 7-year Inheritance Tax gift rule would then apply (see below).

Gifts and Taper Relief

As a rule, there would be no Inheritance Tax to pay on small gifts (also called exempted gifts). Typical examples include Christmas gifts and birthday presents from normal income. The same applies to gifts between spouses or civil partners.

Providing they live in the United Kingdom 'permanently', you can give them as much as you want to during your lifetime. But certain other gifts can count towards the value of someone's estate.

***Note**: Giving away more than £325,000 during the previous 7 years before your death means the recipients will get charged Inheritance Tax.*

What Counts as a Gift for Taxes?

You can contact the Inheritance Tax and probate helpline if you need clarification. But, for the purpose of taxation a gift can be:

- Anything with a value. Typical examples include money, property, shares, and personal possessions.
- A loss in value when something gets transferred. An example would be selling a house to your child for less than it is really worth. The difference in the two values would count as a gift for tax.

Annual Exemption and Exempted Gifts

You can give away gifts each tax year up to the value of £3,000. Your 'annual exemption' means they would not get added to the value of the estate.

Any unused annual exemption can get carried forward to the next year. But it can only happen for one (1) year.

Each tax year (6th of April to 5th of next April) also gives you the opportunity to give away:

- Gifts to charitable organisations and political parties. You can use the Inheritance Tax reduced rate calculator to work out how much you need for qualification.
- Normal gifts paid for out of your normal income (e.g., Christmas presents and birthday gifts). After making these types of gifts you must be able to maintain your usual standard of living.
- Payments to help with someone else's living costs (e.g., a child under the age of 18 or an elderly relative).
- Wedding gifts (or civil ceremony gifts) up to the value of £1,000 per person. The upper limit increases to £2,500 for a grandchild or a great-grandchild and to £5,000 for a child.

Note: Inheritance Tax regulations allow you to use more than one exemption for the same person. So, you could give birthday gifts and wedding gifts to your grandchild in the same tax year.

Small Gifts (up to the value of £250)

In most cases, you can make as many gifts as you like up to 250 per person in the tax year. But you must not have used any of the other exemptions on the same person.

Inheritance Tax 7 Year Rule Taper Relief

Inheritance Tax rates get charged at 40% on anything liable and gifted in the three years before death. Whereas HMRC use a sliding scale (taper relief) on gifts made between 3 and 7 years before death.

- Less than 3 years between the gift and death: 40% tax rate
- 3 to 4 years between the gift and death: 32% tax rate
- 4 to 5 years between the gift and death: 24% tax rate
- 5 to 6 years between the gift and death: 16% tax rate
- 6 to 7 years between the gift and death: 8% tax rate
- 7 years or more: 0% tax rate

Note: Gifts would not count towards the value of the estate after a period of seven (7) years has passed.

Inheritance Tax if Living Abroad

Different rules apply on Inheritance Tax when someone living outside the United Kingdom dies. If your domicile (permanent home) is overseas, then the duty would only be liable on your UK assets.

So, it would include any bank accounts or property that you have in the United Kingdom, for example. But it would be liable on any of the 'excluded assets', such as:

- Foreign currency accounts with a bank or the Post Office.
- Holdings in authorised unit trusts and open-ended investment companies.
- Overseas pensions.

Note: Different rules apply to assets in a trust or government gilts, and to members of visiting armed forces. You should contact the Inheritance Tax and probate helpline if you need further advice and information.

When HMRC Count You as Not Living Abroad

You will get treated as being 'domiciled' in the United Kingdom by HM revenue and Customs if (either):

- You lived in the United Kingdom for fifteen (15) of the last twenty (20) years.
- You had your permanent home in the United Kingdom at any time during the last three years of your life.

Double-taxation Treaty Rules

You may avoid (or reclaim) the tax through a double taxation convention. It may apply if the United Kingdom and an overseas country both charge Inheritance Tax.

The executor of your will might be able to reclaim it through a double-taxation treaty.

For initial advice about Accounting and Taxation, call our team on 0203 488 7503, 01992 236 110 or contact us by email at welcome@walshwestcca.com or via our website www.walshwestcca.com and we will help you.