

Tax explainer: Inheritance Tax



Introduction

Inheritance Tax (IHT) is a tax on the estate of someone who has passed away, including property, money, and possessions. It's also applicable to certain gifts made during an individual's lifetime.

When Does Inheritance Tax Apply?

IHT is charged on the estate if the total value exceeds the £325,000 threshold. If the estate exceeds this threshold, IHT is applied to the amount above £325,000.

- Threshold for individuals: £325,000 (also known as the nil-rate band).
- Threshold for married couples/civil partners: £650,000 (combined).
- Residence Nil-Rate Band (RNRB): An additional £175,000 is available when passing a residence to direct descendants (children, grandchildren).

If the estate is left to a spouse or civil partner, there is no IHT to pay, regardless of the value of the estate.

IHT Rates

The standard rate of IHT is 40% on the value above the threshold.

If at least 10% of the estate is donated to charity, the rate can be reduced to 36% on the remainder.

The Residence Nil-Rate Band (RNRB) of £175,000 applies when a residence is passed to children or direct descendants, effectively increasing the threshold to £500,000 for individuals or £1 million for married couples.

Gifts and IHT

Gifts made during someone's lifetime can also be subject to IHT, depending on the value and timing.

- Gifts made more than 7 years before death: Not subject to IHT (known as 7-year rule).
- Gifts made within 7 years of death: Potentially subject to IHT, with a taper relief reducing the tax depending on how many years before death the gift was made.

Gifts between spouses and civil partners are exempt from IHT.

How to Reduce Inheritance Tax

Minimising IHT can take many years, if not decades to achieve, and involve careful planning with all family members. For high net worth individuals it is strongly recommended that a bespoke plan is developed. Examples of tools that might be deployed in this plan are:

- Make Use of Allowances: Regular gifts of up to £3,000 per year are exempt from IHT.
- Gift to Charity: Donations to charity can reduce the value of the estate and potentially lower the IHT rate.
- Transfer Property to Children: The RNRB provides an additional allowance if a family home is passed to direct descendants.
- Trusts: Setting up a trust can help manage how assets are passed to heirs and reduce IHT liability.

Payment of IHT

IHT must generally be paid by the end of the 6th month after the person's death. If the estate has enough liquid assets (e.g., savings or shares), IHT is usually paid directly from the estate.

If the estate does not have sufficient funds, IHT can be paid in instalments (if the estate includes property) or via assets such as shares or land.

Conclusion

Inheritance Tax can be a significant expense for heirs, but planning ahead can reduce the burden. Understanding IHT exemptions, reliefs, and strategies such as gifting and trusts can help minimise the tax owed.