

# Inheritance Tax Guide

How to save £100,000's in Tax



0800 043 8341



[fathomfinancial.co.uk](http://fathomfinancial.co.uk)



[letstalk@fathomfinancial.co.uk](mailto:letstalk@fathomfinancial.co.uk)



## What is Inheritance Tax?

Inheritance Tax (IHT) is a tax on the estate of someone who has died, including all property, possessions and money. Our guide attempts to explain what IHT is, how to work out what you need to pay and when, and some of the ways you can reduce this tax. It's a very simplistic guide to give you an overview of what is essentially a complex area.

Before we start, just a quick note. Our guide is primarily intended for those looking for initial information about inheritance tax and estate planning. It is not a definitive guide and it isn't advice.

**Capital at Risk:** Some of the solutions outlined will put your Capital at Risk i.e. the value of any investment can go down as well as up. Inheritance tax planning is a complex area and we would encourage you to take advice from a suitably qualified and experienced professional (Solicitor, Accountant, Financial Adviser).

# How much tax do I pay?

It's important to remember that only a small percentage of estates are large enough to pay Inheritance Tax (circa 4–5% in the UK), but it's essential that you assess your IHT position when you make your will and remember there is normally no tax to pay if either:

- The value of your estate is below £325,000.
- You leave everything over the £325,000 threshold to your spouse, civil partner, a charity or a community amateur sports club.

Your estate will however owe tax at 40% on anything above the £325,000 threshold when you die (or 36% if you leave at least 10% of the net value to a charity in your will) – excluding the 'main residence' allowance.



# IHT Scrapped on Some Homes:

The government announced in 2015 that parents or grandparents who pass on their main residence to a direct descendant (children, step-children and grandchildren) get an extra relief called the 'residence nil rate band' (RNRB) worth £175,000 (tax year 2020/2021).

As this is in addition to the basic allowance of £325,000 this takes the individual IHT allowances to £500,000 for singles and up to £1 million for married couples and those in a civil partnership. This makes the application of the allowances unequal for those who do not have children or do not intend to leave their principal residence to a direct descendant, examples on the next page:



Mr Smith is unmarried and has no direct descendants (children, step-children or grandchildren). He would like his nephew to inherit his estate valued at £500,000 which includes his primary residence of £175,000. Mr Smith's inheritance tax liability is worked out as follows:

$$\begin{array}{rcl} \text{£500,000} - \text{£325,000*} & = & \text{£175,000} \\ \text{£175,000} @ 40\% & = & \text{£70,000 (Tax to pay)} \end{array}$$

Miss Smith is unmarried and would like her son to inherit her estate valued at £500,000 which includes her primary residence valued at £175,000. Miss Smith's inheritance tax liability is worked out as follows:

$$\begin{array}{rcl} \text{£500,000} - \text{£500,000*} & = \text{£0} & \text{£0} \\ \text{£0} @ 40\% & = \text{£0} & \text{No tax to pay} \end{array}$$

\* The Inheritance Tax thresholds for the 2020–2021 tax year are £325,000 (Nil Rate Band) and up to £175,000 if you pass your home onto a direct descendant (Residential Nil Rate Band). Please note if the value of your estate exceeds £2,000,000 then the Residential Nil Rate band reduces by £1.00 for every £2.00 above this amount. If the value of your estate exceeds £2,375,000 therefore the RNRB allowance is reduced to zero.

# Who Pays Inheritance Tax and When is it Paid?

If there is a will, it's usually the executor of the will who arranges to pay the Inheritance Tax (IHT). If there isn't a will, it's the administrator of the estate who does this. IHT can be paid from funds within the estate, or from money raised from the sale of the assets.

Inheritance Tax (IHT) must be paid by the end of the sixth month after the person's death. If the tax is not paid within this timeframe, HMRC will start charging interest.

The executors can choose to pay the tax on certain assets, such as property, by instalment over ten years, but the outstanding amount of tax will still get charged interest.

If the asset is sold before all the IHT is paid, the executors must ensure that all instalments (and interest) are paid at that point.

If your estate is likely to incur IHT, it's a good idea for your executor to pay some of the tax within the first six months of death, even if they haven't finished valuing the estate. This is called payment on account.

This will help the estate reduce the interest that it could be charged if it takes longer to sell the assets to pay off the debts and taxes.

If the executor or administrator is paying the tax from their own account, they can claim it back from the estate.

HMRC will refund the estate if it has overpaid IHT once probate has been given. Probate is the right to deal with the deceased person's property, money and possessions. In Scotland this is called confirmation. If you have been appointed executor or administrator of the estate you will need to complete and send in an account of the estate within a year of the death to avoid a penalty.

# Solutions

There are a number of steps and strategies that you can put in place to help mitigate against any future IHT liability. The following are examples of some of the things that you can do, it is not an exhaustive list:

## Gifts that are always tax free:

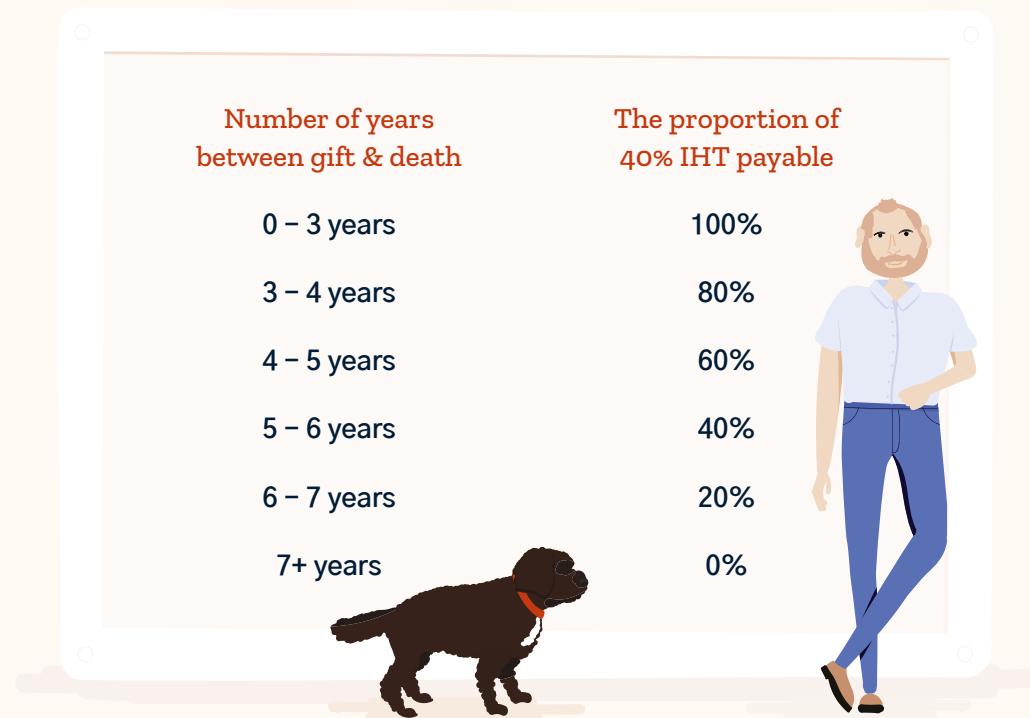
You have an annual £3,000 tax-free gift allowance. If you do not fully utilise your allowance in the previous year this can be combined with your current year's allowance. You can make unlimited tax free small gifts (up to £250 per recipient each year) and there are other gift exemptions such as wedding gifts to children or grandchildren that can also be utilised in addition to the above.

## Gifts that may be tax free:

Most gifts you make during your lifetime, except those above, are 'potentially exempt transfers'. This means they are completely IHT free if you survive seven years after the gift.

However if you die within seven years the total value of the gifts you've made in the previous seven years will be included in your estate and use up part or all of the nil-rate band. If the value of those gifts exceeds the nil-rate band, your estate may have to pay IHT at the full rate or at a discounted rate, known as 'taper relief', depending on when you died.

# How does taper relief work?



## What are the Drawbacks?

You lose control of the asset that you gift, therefore you need to consider how much you can afford to give. You should also consider that for gifts to become completely IHT free you need to live for at least another seven years. Another potential risk in gifting money or assets is that the recipient's circumstance could change (e.g. divorce or bankruptcy).

## Charities and Political Parties:

These gifts are usually exempt from Inheritance Tax immediately.

## Taking out Life Insurance:

With the sum assured (the level of cover) matching the potential IHT bill this would ensure that the IHT 'problem' is dealt with. The option involves paying an amount of money each month, rather than leaving your family with a large tax bill when you die. To be effective the policy would need to be set up on a whole of life basis and written subject to a trust. Temporary life insurance may be suitable in certain circumstances i.e. to cover the potential IHT liability on a gift.



## Trusts:

A trust is an arrangement where you (the settlor) give cash, property, investments or life assurance to a trustee to look after the assets for your intended beneficiaries, there are many different types of trusts:

### Absolute or Bare Trust:

- » Beneficiaries cannot be changed
- » Any beneficiary can demand assets immediately (+18 and of sound mind)
- » Potentially Exempt Transfer

### Discretionary Trust:

- » Beneficiaries can be changed
- » Beneficiaries cannot demand assets
- » Chargeable Lifetime Transfer and could be subject to an immediate and periodic tax charge

### Gift Trust:

- » Set up with a gift to trust
- » Settlor cannot benefit at all
- » Can be set up on an Absolute or Discretionary basis

### Discounted Gift Trust:

- » Set up with a gift to trust
- » Settlor retains the right to regular income
- » Gift may be discounted for IHT
- » Can be set up on an Absolute or Discretionary basis

### Loan Trust:

- » Set up with loan to trustees
- » Loan remains with estate for IHT
- » Access to initial loan and loan repayments
- » Can be set up on an Absolute or Discretionary basis



## Business Property Relief:

BPR has been an established part of inheritance tax legislation since 1976. As an investment incentive, it's relatively straightforward. Once BPR- qualifying shares have been owned for at least two years, they can be passed on free from IHT whilst the owner is still alive or as part of the will.

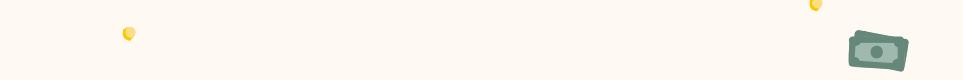
There are a number of schemes available that allow individuals to take advantage of BPR. The principal benefits are the 2 year qualifying period, you are entitled to take any income generated by the investment and if your circumstances change the capital is available to you. An example of one of the products available is highlighted below:

### AIM Inheritance Tax ISA:

As we all know Individual Savings Accounts (ISA's) are very tax efficient vehicles generating tax free income and growth for those that hold them. Introduced to the 'ISA family' in 2013 AIM IHT ISA's typically invest in 20-30 companies that are listed on the Alternative Investment Market (AIM) which are expected to also qualify for BPR.

By investing new monies or transferring existing funds you hold with other providers to an AIM Inheritance Tax ISA you could potentially reduce your IHT liability after holding the investment for two years.

However because of the attractive tax relief these products offer they are generally riskier than your 'typical stocks and shares' ISA. This is because AIM-listed companies tend to be smaller, more volatile and subject to less stringent checks than those quoted on the main London Stock Exchange, the risks are greater. IHT relief is not guaranteed, tax rules can change or the Government may change the rules on BPR in the future.



These are just some of the strategies that you can implement to mitigate against IHT.



It isn't an exhaustive list however many of the products and solutions available will expose investors to different types of risks that they may not have been used to previously. We would urge you to take advice.

We don't charge for our initial IHT reviews. We only charge if you wish to act on our recommendation. And if you don't, that's fine too. Ready to take the first step towards financial peace of mind?

Call us on 0800 043 8341 or email  
letstalk@fathomfinancial.co.uk



# Thank You

Thanks for taking the time to read our guide.  
We hope we've covered everything but if not,  
don't hesitate to get in touch.



0800 043 8341



[fathomfinancial.co.uk](http://fathomfinancial.co.uk)



[letstalk@fathomfinancial.co.uk](mailto:letstalk@fathomfinancial.co.uk)



Fathom HQ, Prosperity House, 1 Barnfield Road,  
Spennymoor, County Durham DL16 6EB



# Fathom

Straight-Talking Financial Experts