hub guides

GUIDE TO INHERITANCE TAX

This guide is designed to help you navigate the complex maze of Inheritance tax (IHT), outlining how IHT works and touching on some of the main areas to consider. If you'd like to discuss any of the points raised, please do not hesitate to contact us.

> **"IN THE 2021-22 TAX YEAR, ONLY 4.39% OF UK ESTATES WERE LIABLE FOR IHT, ACCORDING TO HMRC."**
>
> Source: Gov.uk, 31 July 2024

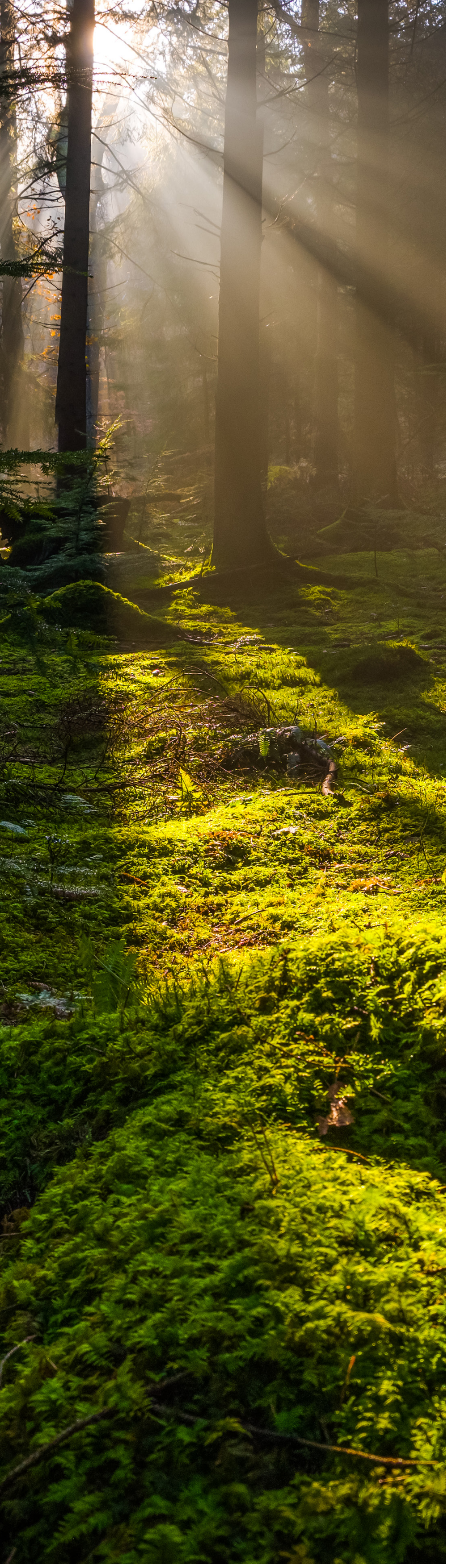
INHERITANCE TAX: THE BASICS

Inheritance tax (IHT) is payable when someone transfers ownership of their assets, usually on death. These assets could include money, property and land, shares, cash paid out by an insurance policy, cars, jewellery or furniture.

Everyone has a tax-free threshold of £325,000 – this is known as the 'nil rate band' (NRB). Estates worth more than £325,000 will pay IHT on anything above that level; however, your estate won't be liable for IHT if everything above the NRB is left in your will to your spouse or civil partner, or to a charity or a community amateur sports club.

The tax rate for all assets over the NRB is 40%. IHT should be paid by the end of the sixth month after death. After this point, it will start to incur interest.

Although only a few estates exceeded the NRB in the past, you shouldn't assume that IHT won't affect you. IHT NRB was frozen at its current level of £325,000 in 2009 and is set to remain unchanged until April 2028. Higher house prices have pushed more people into the IHT net and, alongside ISAs, death-in-service benefit, foreign homes – or less obvious assets such as paintings or cars – the value of an average estate has continued to rise. Moreover, from 2027, the value of your unused pension pot and any death benefits will form part of your estate for IHT purposes.



SOME EXEMPTIONS AND ALLOWANCES TO CONSIDER

Individuals can reduce the value of their chargeable estate by taking advantage of certain tax-free allowances. So if you want to pass on as much of your hard-earned cash as possible to your heirs, you should aim to make the most of the available exemptions and allowances if you can. Some of the basics are outlined below; however, IHT is a complicated area, and everyone's situation is different, so it's important to gain professional advice that's tailored for your personal circumstances.

TRANSFERS BETWEEN SPOUSES/CIVIL PARTNERS

in addition to the £325,000 NRB available on each estate, transfers between spouses or civil partners are free of tax. Legally recognised partners can also transfer any unused portion of their own NRB so that, in effect, the surviving spouse has a NRB of up to £650,000. However, this does not apply to unmarried partners.

RESIDENTIAL NRB:

an additional residential NRB enables individuals to pass on their main residence to direct descendants – such as a child or grandchild – without incurring IHT. This allowance is £175,000 in the current tax year. When added to the existing NRB of £325,000, this creates an IHT threshold of £500,000 for estates.

- Any of this unused allowance can be transferred to the surviving spouse or civil partner, raising the effective IHT threshold to £1 million; however, estates with a net value of over £2 million will suffer a tapered withdrawal of the main residence NRB.

POTENTIALLY EXEMPT TRANSFERS (PETS):

if an individual dies within seven years of making a gift – perhaps money, property, shares or personal items such as jewellery – it will be counted as part of their estate and could incur IHT. Therefore, assets transferred before death are termed 'potentially exempt transfers' (PETs) for IHT purposes. They are 'potentially exempt' because, from the day you give them away, the tax due on death is subject to a tapering over seven years, starting at 100% of liability for the first three years, then falling proportionally over the next four. If you survive the full seven years, the IHT liability on that asset becomes zero. (It's worth noting that, in some cases, you could have to look back as far as 14 years.)

- If you make a gift but also continue to enjoy the benefit of the asset in question, that gift won't qualify as a PET. For example, if you transfer ownership of your home to your children, but continue to live in it, that gift won't meet 'potentially exempt' criteria unless you pay full market rent to your children.
- You can make various gifts each year free of IHT. For example, in each tax year, you can give a total of £3,000-worth of gifts, and as many gifts of up to £250 as you like, as long as you haven't used another allowance on one of those recipients. You can also give a tax-free gift in the event of a marriage or civil partnership, although the tax-free amount will vary depending on your relationship with the happy couple. Gifts between spouses or civil partners are exempt, and gifts to charities can also reduce the IHT payable on your estate.

contact

We hope you found the information in this guide useful and informative. If any of the points are of interest, or you would like to discuss your own situation in more detail, please get in touch.

Produced by adviser-hub.co.uk on behalf of your professional adviser.

This guide is intended to provide information only and reflects our understanding of legislation at the time of writing. Before you make any decision, we suggest you take professional financial advice. Updated April 2025

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TWO PRACTICAL STEPS TO TAKE

1 – MAKE A WILL ...

Making a will is vital, particularly if you're not married or in a civil partnership. If you die 'intestate' (without a will), your estate will be divided up according to the rules of intestacy, and unmarried partners have no automatic right of inheritance. The rules of intestacy vary depending on whether you live in England and Wales, Northern Ireland, or Scotland.

"ACCORDING TO THE MONEY ADVICE SERVICE, 56% OF UK ADULTS HAVEN'T MADE A WILL."

Source: Money & Pensions Service, 27 Jan 2025

2 – ... AND ABOVE ALL, TAKE EXPERT ADVICE!

Estate planning is complicated and there's a lot to consider. As well as making the most of the various allowances and exemptions, there are other possible strategies that can help to mitigate IHT – for example, trusts, discounted gift plans, or various investments that qualify for tax relief – so it's very important to take professional advice to find the strategy that's right for you.

Careful planning can help you to take advantage of all the allowances and reliefs available, and it's never too early to start. Expert advice and a little forward planning can make a world of difference, so if you'd like to discuss your own situation in more detail, please get in touch.