Teachers Financial Planning

Inheritance tax planning

A guide to minimising inheritance tax.

Inheritance tax (IHT) is paid on an individual's estate (property, possessions and money) if it is worth more than £325,000 in total when they die.

This £325,000 is referred to as the IHT threshold. The current IHT rate of 40% is levied on anything above this figure. An exception to this is when 10% of an individual's estate is left to charity, in this case the IHT rate is reduced to 36%.

Who is responsible for paying inheritance tax?

The executor of the will or the administrator of the deceased's estate is generally the person who is responsible for paying IHT.

Trustees pay IHT on trusts using funds from the trust. The beneficiaries of a will do not usually have to pay IHT. However, there may be other taxes that they will have to pay.

IHT should be paid by the end of the sixth month following a person's death.

Tax exemptions and reliefs

There are a number of tax allowances and exemptions that can be claimed against IHT. It is prudent to check which exemptions you or your family and/or beneficiaries are entitled to when planning for IHT.

Personal exemptions

Individuals who work in sectors or roles that are considered high risk are exempt from paying IHT if they die in active service.

If someone who is no longer engaged in this high-risk work dies as a result of an injury suffered whilst on active service, they are also exempt.

The roles considered exempt are:

- people serving in the armed forces
- members of the emergency services
- humanitarian aid workers.

Business relief

Business relief is only applicable if the deceased owned or controlled the business for more than 2 years prior to their death. The market value of the business must be the basis for any business relief calculations.

Business relief of 100% may be claimed on a business or shares in a business that is unlisted.

Business relief of 50% may be claimed on shares controlling over 50% of voting rights.

The 50% relief may also be claimed on property owned by the deceased and used by a business they owned or controlled and business property held in a trust.

There are certain circumstances where business relief cannot be claimed.

Agricultural relief

Agricultural relief allows some agricultural property to be passed on exempt from IHT. It is 100% if the deceased owned and farmed the land or if it was let on a tenancy after 1995. There is a minimum qualifying ownership period of 2 years (7 years if the property was let to someone else).

Other circumstances allow for 50% relief.

Agricultural property qualifying for agricultural relief is land used to grow crops or intensively farm animals. There are other instances where this relief can apply.

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Derelict buildings, machinery, crops, animals and property subject to a binding contract for sale are not eligible for agricultural relief.

Woodland relief

Woodland relief cannot be claimed if the woodland in question is also subject to agricultural or business relief. IHT is only paid on the trees when they are sold or given away as timber.

Heritage assets

In some cases buildings, land and works of art that have a significant historic or scientific interest are exempt. They must be made available for the public to view amongst other conditions in order to qualify.

We can advise on whether your estate is eligible for any of these reliefs.

Gifts and potentially exempt transfers

If the deceased gave some of or all of their assets away as a gift before they died then IHT does not have to be paid. A gift or potentially exempt transfer can include:

- property, money and possessions
- a loss in value when something is transferred i.e. if a parent sells something to their child for less than it is worth, the difference is considered a gift.

IHT is not levied on gifts between married couples or civil partners if they are permanent UK residents.

The 7-year rule

After giving something as a gift the original owner must live for 7 years after the date the gift was given to be exempt from IHT. Any gifts made less than 7 years before death are considered part of the threshold of £325,000. The rate of tax is reduced on gifts made 3-7 years prior to death. These rates are tapered and are as follows:

- less than 3 years - 40%
- 3-4 years - 32%
- 5-6 years - 16%
- 6-7 years - 8%.

There is no IHT levied on the following gifts and circumstances:

- up to £3,000 of gifts each year
- in addition to the annual gift exemption, any number of gifts worth up to £250 may be given in a year
- regular gifts from the deceased's income including Christmas and birthday gifts, payments into a savings account and life insurance policy premiums
- payments to assist with living costs to certain individuals
- payments to charities, museums, community sports clubs and universities
- gifts to political parties provided they have at least 2 MPs or 1 MP and got at least 150,000 votes in a general election.

Trusts

Establishing a trust can be an effective method of reducing IHT while retaining some control over assets. Different types of trust are subject to differing tax rates and rules.

Bare trusts hold assets in the name of a trustee but eventually go to a beneficiary who has the rights to the income from the assets and the assets. Transfers into bare trusts may be exempt if the person survives for 7 years after the transfer.

Interest in possession trusts are where beneficiaries are entitled to income from the trust as it is produced. There are different rules for IHT depending on when the assets were transferred into the trust.

Will trusts may be set up at the request of the deceased in their will. IHT is liable on some will trusts.

Trusts for bereaved minors are not subject to IHT if the assets are set aside or they are entitled to them when they are 18.

Trusts for disabled beneficiaries are not liable for IHT provided the person making the transfer survives for 7 years. Additionally as long as the assets remain in the trust there is no 10 yearly or exit charge levied on this type of trust.

Why plan for inheritance tax?

IHT planning is potentially the most important tax planning an individual can do. Done properly it can save thousands of pounds and create genuine peace of mind for your beneficiaries.

Contact us to discuss financial planning.