TECHNICAL SALES BRIEFING

IHT "BITESIZE" SERIES - PART ONE
INTRODUCTION AND IHT BASICS

KEY POINTS

This Technical Sales Briefing:

- is the first in a series covering many aspects of UK Inheritance Tax (IHT)
- explores some IHT basics including Domicile, the Measure of the IHT Charge, Valuations, Transfers of Value, the Rates of IHT and the payment of the tax itself.

BACKGROUND TO INHERITANCE TAX

Inheritance Tax (IHT) was introduced on 18 March 1986 to replace Capital Transfer Tax which had, in turn, replaced Estate Duty on 12 March 1975. The main provisions governing IHT are contained in the Inheritance Tax Act 1984 (IHTA 1984).

IHT is generally thought of as a tax payable on death but it can also be payable on certain lifetime transfers, principally transfers to discretionary trusts and, indeed, most other trusts after 22 March 2006.

However, IHT can often be mitigated through good financial planning and this is an area where advisers can add value. This briefing provides several worked examples to try and better explain the operation of certain aspects. In addition, we would also encourage advisers to read HMRC's online IHT guidance: **https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual**

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DOMICILE AND ITS IMPORTANCE FOR DETERMINING LIABILITY TO IHT

A key factor in deciding the extent to which there is a liability to IHT is the domicile of the person making the transfer. It is of no direct consequence for IHT purposes whether a person is 'resident' in the UK for tax purposes, although a lengthy period of continual UK residence could cause them to be deemed domiciled in the UK as discussed later in this section.

- A UK domiciled person is assessable to tax on transfers of any assets wherever the assets are situated
- A non-UK domiciled person is only assessable on transfers of assets situated in the UK.

DOMICILE

A person is domiciled in the UK if, broadly, they are deemed to consider the UK their home by virtue of their day to day actions. Factors such as having a house, working and having a family in the UK will all be taken into account in determining a person's domicile. For most IHT purposes, UK domicile covers persons:

- Domiciled in the UK under general law at any time during the three years preceding the transfer; or
- Deemed Domicile which applies where a person has been resident in the UK in not less than 15 of the 20 tax years preceding the transfer. From 2017/18 anyone who meets this criterion will be deemed UK domiciled for all tax purposes.

Since 6 April 2013, it has been possible for a non-UK domiciled spouse to make an election to be treated as being UK domiciled for IHT purposes. If such an election is made, then the normal spousal exemption will apply in full to all transfers made to the previously non-UK domiciled spouse.

Since 2017/18, all UK residential property held directly or indirectly by a non-UK domiciled person will also be brought into charge for IHT purposes and will not be considered excluded property. This affects all UK residential property which is owned by trustees, an offshore company or a partnership.

Domicile and indeed UK residence is a complex matter and more detailed information on this can be obtained by reading our **Guide to Domicile, Residence and the Remittance Basis** which is available from our website **www.utmostinternational.com**

MEASURE OF CHARGE

The amount chargeable to IHT on lifetime transfers is measured by the transferor's loss to their estate and not necessarily the value passing to the transferee. No account is taken of other taxes, for example capital gains tax, or incidental expenses.

If the transferor bears the tax, IHT on a chargeable lifetime transfer (CLT) is calculated on the value transferred plus the tax which is referred to as 'grossing-up'. If the transferee bears the tax there is no grossing-up.

A person's estate comprises all the property to which they are beneficially entitled or which they can dispose of as they see fit. The estate also includes any 'gifts with reservation' made since 18 March 1986 (Gifts with reservation is dealt with in part three of the bitesize series. This information is also available on page 28 of the Inheritance Tax Manual.) The value of some settlements, or a part thereof, may also be added to the total.

EXAMPLE 1 – LOSS TO THE ESTATE PRINCIPLE

For transfers of value it is always the loss to the estate by the transferor which is taken into account for IHT calculations, not the value received by the transferee.

Billy owns 550 shares (a 55% holding) in ABC Ltd and he decides to give 150 (15%) of these shares to his son John. Billy's spouse Barbara does not own any shares in the company. As Billy owns a majority shareholding in ABC Ltd, the value of his shares before and after the gift will be quite different as his loss of control in ABC Ltd must be taken into account. In other words, we cannot just apportion the value of his shares actually gifted using a 55% holding and instead must look at the values of the shares in their own right before and after the gift. We will assume the following valuations for different holdings of shares in ABC Ltd:

A 55% holding is worth £137,500

A 40% holding is only worth £60,000 (not £100,000, which would be the apportioned value)

A 15% holdings is then worth £18,000

Here Billy's loss, and thus the value deemed transferred, is calculated as £137,500 - £60,000 = £77,500. This is calculated as his effective loss, which is the difference between the current value of his holding and the value after the transfer. This is considerably different to the value of the shares received by his son John which are valued at £18,000.

VALUATION AND POST MORTEM RELIEFS

VALUATION OF ASSETS FOR IHT PURPOSES

The general basis of valuation of an asset is the value it would fetch if sold on the open market and this will often be a matter for negotiation with HM Revenue & Customs. If a transfer of value (as explained later in this briefing) reduces the value of assets retained by a transferor, these assets have to be valued before and after the transfer in order to determine the loss to the transferor.

RELATED PROPERTY

This occurs where the assets of a husband and wife or civil partners are worth more when taken together than if valued in isolation. For example, if there was a pair of antique vases where they each own one vase, the assets of each of them are valued as a proportion of the total value.

The way related property is valued depends on the property itself. Shares are valued in relation to the combined value, whilst chattels are apportioned using the following formula:

A / A + B x C

Where:

A - Is the value of assets held by spouse A

B – Is the value of assets held by spouse B

C – Is the combined value of the assets

POST MORTEM RELIEFS

There are also post mortem reliefs available if, following death, certain assets drop in value. As the asset could be sold to claim a reduction and immediately repurchased there are anti-avoidance measures to counter this type of 'bed and breakfast' arrangement. The relief and restrictions on reinvestment are dependent on the type of asset and these are listed in the table below:

TYPE OF ASSET	DEADLINE FOR CLAIM	REINVESTMENT RESTRICTION
Quoted shares or securities	Within 12 months of death (IHTA '84 s179)	2 months after the last sale in the 12 month period
Land and Buildings	Within 3 years of death (IHTA '84 s191) - certain small losses are ignored if less than the lower of 5% of the probate value or £1,000.	4 months after the final sale in the 3 year period

There is also a similar provision (subject to numerous qualifications and special rules) for the lower value to be substituted for the calculation of any tax, or additional tax, arising on death within seven years of a potentially exempt transfer or a chargeable lifetime transfer where the value of property has decreased.

EXAMPLE 2 – FALL IN VALUE RELIEF

Carl is UK domiciled and has never married. He dies in tax year 2021/22 with a house in Southampton worth £500,000 at the date of his death and £20,000 in a UK bank account. He leaves his entire estate to his daughter Samantha. Ordinarily, Carl's estate would be liable to IHT as follows:

House	£500,000
Bank Account	£20,000
Total	£520,000
Less RNRB	(£175,000)* RNRB is used up first *Tax year 2021/22
Less NRB	(£325,000)
Amount subject to IHT	£20,000

Following Carl's death, Samantha decides that she would like to sell the house. It takes a while for the executors to sell the house and the value actually obtained is much less than the probate value of £500,000. It eventually sells two years later for a value of only £400,000; a drop in value of £100,000 or 20% from the original probate value. Here the executors could make a claim under s191 to substitute the sale value instead of the probate value of £500,000. As the drop in value is more than the amount subject to IHT, the effect is to wipe out any IHT due on the estate.

TRANSFERS OF VALUE AND EXEMPT TRANSFERS

A transfer of value is any disposal made by which the value of the transferor's estate is reduced. However a disposal is not a transfer of value and therefore not liable to IHT if it is:

- an exempt transfer, such as transfers to UK domiciled spouses or gifts to UK or EEA charities
- shown that it was effectively a commercial transaction and not intended to confer any gratuitous benefit. For this to apply it must be made either:
  - between persons not connected with each other, or
  - on terms that might be expected to be made at arm's length between persons not connected* with each other.

  *Connected persons would include a spouse and other relatives, including uncles, aunts, nephews and nieces.
- allowable in computing profits or gains for income tax or corporation tax purposes
- a contribution to a registered pension scheme
- to provide benefits on or after retirement for a person who is not connected with the provider who is or was employed by him up to approvable limits (or for that person's widow(er) or dependant(s))
- the waiver or repayment of remuneration assessable under the Income Tax (Earnings & Pensions) Act 2003 (formerly Schedule E)
- the waiver of a dividend on shares within 12 months before the right to the dividend accrues.

RATES OF IHT

From 5 April 2026 the rates are as follows:

TAXABLE ESTATE	RATE ON DEATH
0 - £325,000	NIL
Over £325,000	40%*

The band where no IHT is payable is referred to as the Nil Rate Band (NRB). The NRB threshold is £325,000 and is to remain at this level for the tax years up to and including 2025/26.

*From 6 April 2012, the rate is 36% where an individual leaves 10% or more of their baseline amount, as given in Schedule 1A(5) IHTA 1984, to charity. The 'baseline amount' is calculated as the amount charged to IHT **after** the deduction of any available NRBs and exemptions. There is no requirement here to claim the reduced rate and if the estate qualifies then it automatically applies.

Transferable Nil Rate Bands (TRNB) - from 9 October 2007, any proportion of unused NRB on the first death of a spouse/civil partner can be transferred to the survivor's estate on his/her subsequent death.

Chargeable lifetime transfers - (discretionary trusts, and most other trusts after 22 March 2006) are taxed at half the death rate, currently 20%. Such a charge will arise where the settlor's cumulative total of chargeable transfers in the previous seven years exceeds the NRB.

EXAMPLE 3 – USE OF CHARITABLE GIFTS ON DEATH

Sally, who was UK domiciled, died in 2018 leaving her entire estate to her husband Bob. Bob subsequently dies in October 2021 with an estate valued at £700,000 on his death. Sally and Bob never owned their own home, and thus no Residence Nil Rate Band (RNRB) is available. (We have a separate briefing for RNRB which is available on the uTech site. RNRB will also be covered briefly in part four of the bitesize series and is covered on page 22 of the Inheritance Tax Manual.) In his will Bob leaves his entire estate to his son Charles and £4,000 to charity. As Sally did not use her NRB on death, the NRB available on Bob's death is uplifted by a full 100%. This gives Bob's estate an available NRB of £650,000. We can therefore work out the IHT due on Bob's estate.

First, let's consider the 'baseline amount':

Estate value	£700,000
Less NRB x2	(£650,000) 2021/22*
'Baseline amount'	£50,000

*The NRB of £325,000 is uplifted by 100%

Now calculate the IHT chargeable on the estate:

Estate value	£700,000
Less charitable gift	(£4,000) (less than 10% of the baseline amount)
Less NRB x2	(£650,000) 2021/22*
IHT due	£46,000 x 40% = £18,400
Amount received by Charles	£677,600
Amount received by charity	£4,000

*The NRB of £325,000 is uplifted by 100%

Suppose instead Bob had altered his will to leave £5,000 to charity, his estate would then qualify for the reduced rate of tax, £5,000 being 10% of the baseline amount. This would reduce the IHT payable on the estate to 36%. As the gift to charity is an exempt transfer, the position following this gift would be as below:

Estate value	£700,000
Gift to charity	(£5,000)
Less NRB x2	(£650,000) 2021/22*
Taxable estate	£45,000
IHT due	£45,000 x 36% = £16,200
Amount received by Charles	£678,800
Amount received by charity	£5,000

*The NRB of £325,000 is uplifted by 100%

The effect here is that Charles receives more money and the charity also receives a larger donation of £5,000. The only loser here is HMRC who receives less IHT as a result of the charitable gift. This type of planning can be effected by putting a clause in the will to make sure the relevant amount is left to charity and, as shown above, can be quite effective in IHT planning.

Note that where no charitable gifting was originally included in the will, such a clause will not usually provide any additional benefit to the beneficiary(ies). This is because the inclusion of a substantial charitable gift will significantly reduce the amount received by the beneficiary, despite the rate of IHT being reduced to 36%. However, where charitable gifting in the will is just below the baseline threshold of 10%, it is advisable to check to see whether amending the will could provide a greater legacy.

PAYMENT OF TAX AND INSTALMENTS

Tax on a chargeable transfer (CLT) made during a person's lifetime is payable on the date which is **the later** of either:

› Six months after the end of the month in which the transfer is made, or

› At the end of April in the following year.

This means tax on lifetime transfers from the start of the tax year until 1 October will become payable by the end of the following April and tax on transfers after 1 October up to the end of the tax year will become payable six months after the month in which they are made.

On death any tax as a result of failed transfers (CLTs and PETs) must be paid within six months of the date of death. The executors must also pay any tax on the estate within six months of death. However, the deceased's personal representatives must also pay any tax for which they are liable before they apply for probate, even if this is before the due date. In practice this may lead to positions where they cannot obtain probate simply because they have no funds to cover the IHT.

Here it may be possible for the personal representatives to draw on funds held in the deceased's bank and building society accounts for the purpose of paying any IHT that is due before the grant of probate. Alternatively, the personal representatives may need to fund the IHT from either their own pockets or by way of loan, both of which can be repaid once they obtain probate.

Tax payable on death in respect of the following qualifying property (s227(2) IHTA 84) may be paid by ten equal yearly instalments, the first being payable six months after the end of the month in which death occurs:

› the value of a business or an interest therein (including partnerships)

It should be noted that the ability to pay tax in instalments is not relevant where the assets qualify for 100% business relief. It will, however, continue to be useful in the following circumstances:

› Where there are excepted assets and where only 50% business relief is available

› Shares or securities which gave the deceased control, or together with related property would have given control of the company at the deceased's death

› Non-controlling holdings on unquoted shares (including AIM listed shares) where:

- not less than 20% of the tax payable by the person accountable is in respect of those shares or other tax payable by instalments, or
- the value transferred exceeds £20,000 and the nominal value is 10% or more of the value of all the shares in the company or, if ordinary shares only, 10% or more of the value of all the ordinary shares in the company, or
- HM Revenue & Customs is satisfied that the sum cannot be paid in one sum without undue hardship

› Land of any description (including buildings) wherever situated.

The facility to pay tax by instalments extends to lifetime transfers where the transferee pays the tax and to transfers involving settled property provided that the property continues to be included in a settlement.

Interest on the whole of the tax outstanding is added to each instalment for both transfers on death and lifetime transfers. However, where tax is payable by instalments in respect of business assets, land and buildings eligible for agricultural relief, interest will be payable from the due-date of the instalment in respect of only that instalment which has become due but not paid. Note land and buildings are not necessarily business assets if they are not owned by a controlling shareholder and used by the business.

Payment by instalment will only apply to potentially exempt transfers which become chargeable if the donee has retained the qualifying property until the donor's death (or, if earlier, his own death).

FURTHER UPDATES IN THIS SERIES AND OUR UTECH SITE

The next Technical Sales Briefing in this series will look at Lifetime Transfers of Value, Taper Relief and considerations around life cover.

Note the content in this briefing is taken from our comprehensive Inheritance Tax Manual which is available in the Technical Briefings section of our uTech site (utmostwealth.com/utech). uTech has several other technical briefings exploring the more niche and complex areas of UK IHT. These include several guides to the Residence Nil Rate Band and a detailed briefing exploring Domicile, Remittance Basis and Excluded Property.

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