For paraplanners and financial advisers only

Inheritance tax (IHT): The details that could trip up paraplanners

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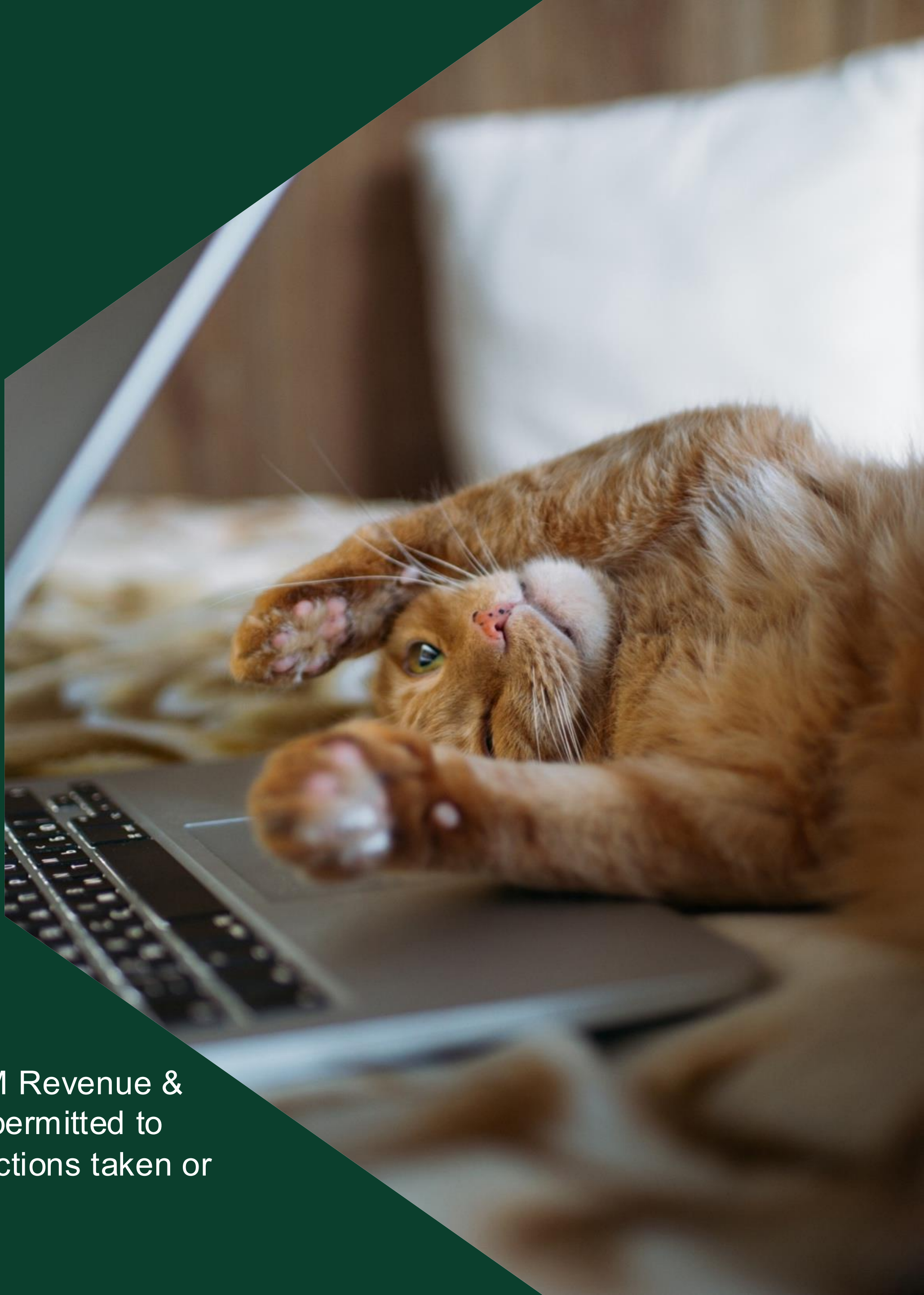

Learning objectives

1. Consider the impact of UK long term residency on an individual's UK IHT exposure and on the availability of the spouse exemption.

2. Appreciate how to calculate the transferable nil rate and how to work out the residence nil rate band applying to an estate.

3. Review other possible IHT planning solutions.

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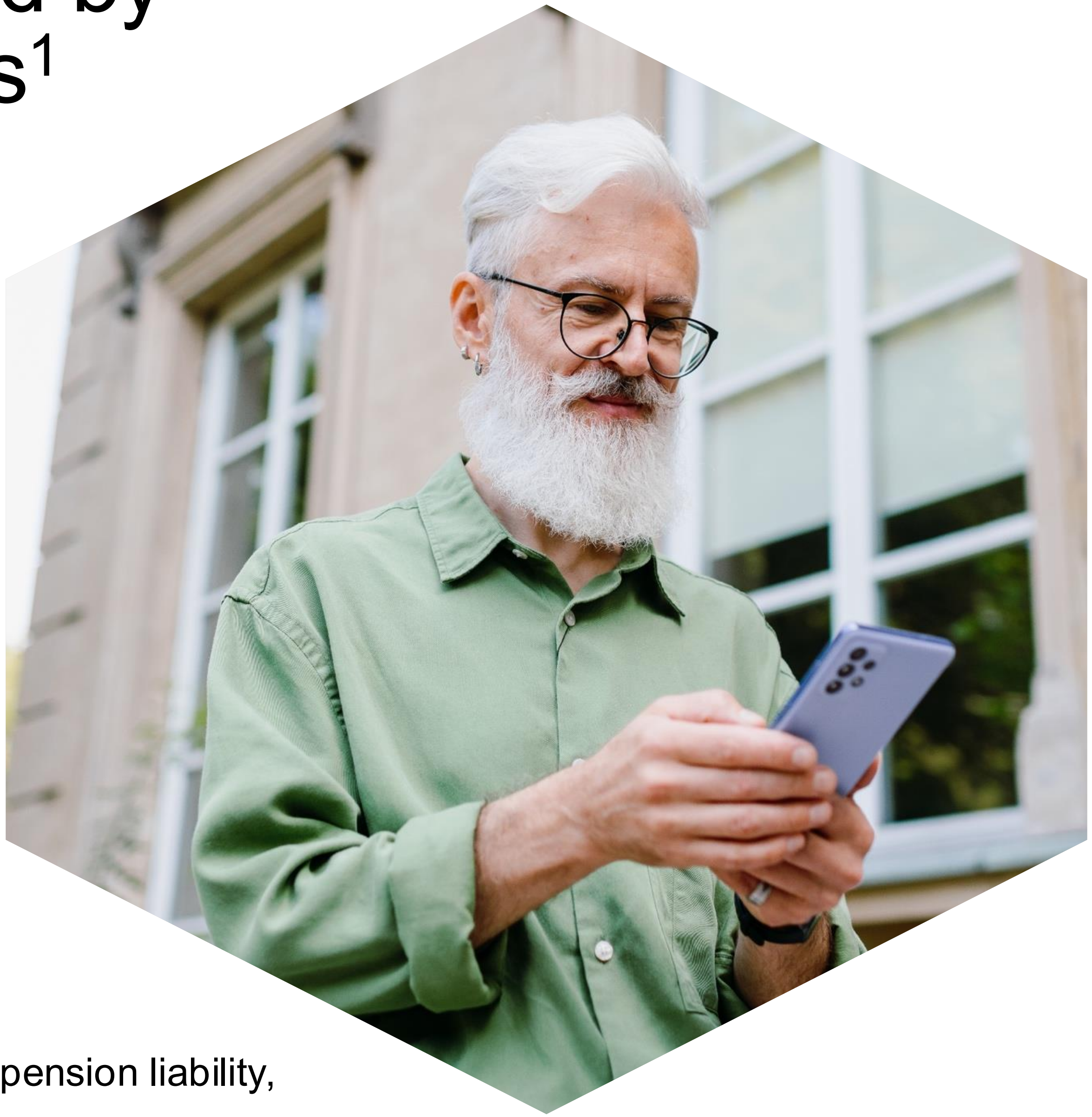
Numbers likely to be affected by extension of IHT to pensions[1]



10,500 new estates not previously affected.

38,500 estates paying more.

Average **£169,000** IHT liability currently.

Average increasing by **£34,000** when pensions included.

Figures don't factor in behavioural changes.

[1] Source: HMRC Technical Consultation – Inheritance Tax on pension liability, reporting and payment

Key considerations in mitigating an IHT liability

- Establish client's objectives.
- Assess the client's assets/liabilities.
- Consider their future need for access to income and capital.
- Calculate their current and projected future IHT exposure.
- Look at the tax position of each asset to determine the implications of gifting now, making regular gifts, or retaining assets until death.

Some possible IHT mitigation options

Will planning

Creating a legacy with life assurance

Make lifetime gifts and use exemptions

Gift assets to charity in lifetime or via the will

Junior products – JISA, Junior SIPP

Trusts

Using reliefs:
Business relief, agricultural relief

Family investment companies or family limited partnerships

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Who is subject to UK IHT?

From 6 April 2025 new residence-based test replaces domicile regime for IHT.

UK sited assets subject to UK IHT.

Non-UK sited assets, subject to UK IHT if individual has been UK tax resident for at least 10 of the previous 20 years, immediately preceding year of chargeable event.

Residence status determined by statutory residence test.

Tail is three tax years, where period of UK residence between 10-13 years (then increased by one additional year for each additional year of UK residence, with a maximum tail of 10 years).

Spouse exemption

No restriction if assets passing from:

- UK long term resident spouse to UK long term resident spouse, or
- Non-UK long term resident spouse to UK long term resident spouse.

Restricted to £325,000 if assets passing from:

- UK long term resident spouse to non-UK long term resident spouse. Non-UK long term resident spouse can elect to be treated as UK long term resident to qualify for full spouse exemption.

Making regular gifts – IHT exemptions

Lifetime

- Annual £3,000
- Small gifts exemption
- Normal expenditure out of income
- Gifts in consideration of marriage
- Gifts for family maintenance

During lifetime or on death

- Spousal transfers
- Gifts to charity
- Gifts to political parties
- Gifts for national benefit

IHT– lump sum gifts

Potentially exempt transfer (PET)

- Gifts from one individual to another.
- Gifts to some trusts (bare trusts and disabled trusts).
- No limit to the amount gifted.
- Falls outside the estate on surviving for seven years.
- If death occurs within seven years, taper relief may apply to any IHT due.

Chargeable lifetime transfer (CLT)

- Gifts into most trusts since 21 March 2006.
- If gift exceeds donor's available nil rate band[1], lifetime IHT on excess at 20% if paid by recipient or 25% if paid by donor.
- IHT recalculated at 40% if donor dies within seven years and taper relief may apply to any IHT due.
- Credit given for any lifetime IHT paid on the CLT.

[1] Can't offset any transferable nil rate band for the purposes of the lifetime tax.

IHT on a potentially exempt transfer (PET)

- David wants to make a gift of £500,000 to his daughter, Lily (age 21).
- He hasn't made any previous gifts apart from using his annual £3,000 exemption for this year and last.
- Potential IHT liability will reduce with taper relief.

Potential IHT due	Death occurs
£500,000 - £325,000 = £175,000 x 40% x 100% = £70,000	Years 1-3
£175,000 x 40% x 80% = £56,000	Years 3-4
£175,000 x 40% x 60% = £42,000	Years 4-5
£175,000 x 40% x 40% = £28,000	Years 5-6
£175,000 x 40% x 20% = £14,000	Years 6-7

This case study is for illustrative purposes only.

IHT on a chargeable lifetime transfer (CLT) to a Discretionary Trust

John creates a Discretionary Trust on 1 June 2024.

He transfers £500,000 to the trustees.

He has made no other chargeable transfers in the previous seven years, and his annual exemption has been used elsewhere.

What would the lifetime charge be?

Gift	£500,000
Less nil rate band	£325,000
	£175,000
IHT at 20%	£35,000

This case study is for illustrative purposes only.

IHT on a chargeable lifetime transfer to a Discretionary Trust

John creates a Discretionary Trust on 1 June 2024.

He transfers £500,000 to the trustees.

He has made no other chargeable transfers in the previous seven years, and his annual exemption has been used elsewhere.

John dies on 1 August 2029.

What would the position be on death?

Gift	£500,000
Less nil rate Band	<u>£325,000</u>
	£175,000
IHT at 40%	£70,000
Died in year 5-6 so 40% due to taper relief	£28,000

Lifetime IHT paid was £35,000 – no IHT payable but no refund either.

This case study is for illustrative purposes only.

14-year rule

Step one

CLTs and failed PETs made in the seven years before death are chargeable in chronological order starting with oldest first.

Step two

Must consider the cumulation of chargeable transfers ('failed' PETs and CLTs) made in the seven years before each gift as they will impact the available nil rate band.

14-year rule – example

Case study

- Jane made a gift of £300,000 into a discretionary trust on 30 June 2017 (CLT).
- She made a gift of £250,000 to her daughter on 27 June 2023 (PET).
- She passes away on 3 June 2026.

Steps

1. The PET on 27 June 2023 becomes a failed PET.
2. Look back seven years from the failed PET to see if there were any other CLTs or failed PETs.
3. In this example, there was a CLT made in the seven years before the failed PET. This CLT reduces the nil rate band available to offset against the PET.
4. The IHT calculation would be £300,000 + £250,000 less £325,000 = £225,000 x 40% = £90,000 IHT due. No taper applies as death within three years of PET.

This case study is for illustrative purposes only.

IHT– transferable nil rate band

- Available to a surviving spouse who dies after 9 October 2007.
- Amount depends on the unused percentage of the nil rate band on the first spouse's death.
- The unused percentage will be applied to prevailing nil rate band on second death.
- Personal representatives must make a formal claim (IHT402) to transfer any unused allowance on the surviving spouse's death.
- Can be transferred on more than one death, if surviving spouse pre-deceased by more than one spouse, but up to a maximum of 100%.
- Important to keep good records from the previous death(s).

Transferable nil rate band

One marriage

Jack's death

Jack dies on 1 June 2020, when the nil rate band is £325,000.

His estate is £500,000 and he leaves £156,000 to his children and the remainder to his wife, Jane.

Transfers between spouses are exempt.

Jack's nil rate band is 52% unused ((325,000 – 156,000)/325,000).

Jane's death

When Jane dies on 30 June 2026 the prevailing nil rate band is also £325,000.

The nil rate band available to offset against Jane's estate is:

£325,000 + 52% x £325,000 = £494,000.

This case study is for illustrative purposes only.

Two marriages

Transferable nil rate band

Jack's death

Jack's nil rate band is 52% unused following his death as per the previous slide.

Jim's death

Jane remarries on 14 February 2021 and Jim dies on 25 September 2025, when the nil rate band is £325,000.

His estate is £700,000 and he leaves £250,000 to his children and the remainder to his wife, Jane.

Jim's nil rate band is 23% unused ((325,000 – 250,000)/325,000).

Jane's death

When Jane dies on 30 June 2026 the prevailing nil rate band is also £325,000.

The nil rate band available to offset against Jane's estate is:

£325,000 + 52% x £325,000 + 23% x £325,000 = £568,750.

This case study is for illustrative purposes only.

Residence nil rate band

- Death after 5 April 2017.
- Deceased must leave an interest in a property that has been a main residence at some point to one or more direct descendants (children, children's spouses, grandchildren, grandchildren's spouses, adopted and step-children).
- The home must be left to them in the will, under the rules of intestacy or by some other legal means.
- Can be inherited as part of the residue of the estate.

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Residence nil rate band

- Does not apply to chargeable lifetime transfers for the purposes of the lifetime tax.
- Applies to those who downsize or stop owning property after 7 July 2015, to the extent direct descendants inherit assets from the estate up to the value of the former property.
- Where the estate is worth more than £2 million, the residence nil-rate band is tapered away.
- To extent unused, will be transferable to surviving spouse.
- HMRC has a calculator to work out how much residence nil rate band applies.

Residence nil rate band

Example

Amanda died in May 2026 leaving a house worth £150,000 and other assets of £450,000 to her daughter.

In the tax year 2026/27, the maximum available nil rate band is £175,000.

Residence nil rate band applying to Amanda's estate = £150,000 (the lower of £175,000 and £150,000).

Calculation

Value of estate		600,000
Less residence nil rate band		(150,000)
Less nil rate band	<u>(325,000)</u>	
		125,000
IHT at 40%		£50,000

This case study is for illustrative purposes only.

Residence nil rate band (RNRB) planning

Review will trusts:

- Discretionary trusts generally prevent property from being 'closely inherited',
- Immediate post death interest trust can qualify.

Failed potentially exempt transfers and chargeable lifetime transfers don't count towards the £2,000,000 taper threshold.

Use RNRB (and nil rate band) on first death to avoid loss due to taper on second death.

Wills

53% of adults in the UK have made a will.

41% of 18-24 year olds have a will, increases to 47% of 25-54 year olds and 69% of those over age 55.

Those who are single are less likely to have a will than someone in a relationship or living with a partner.

The three biggest areas for will writing are Scotland (58%), London (57%) and the South West (57%).

Source: The National Wills Report, 2024

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Does your client have a will in place?

- Personal Representatives.
- Review existing will trust(s).
- Use of spouse exemption.
- Maximise transferable nil rate band / residence nil rate band.
- 36% reduced IHT rate.
- Revisit where percentage of the value of the estate left to beneficiaries.

36% rate of IHT

The IHT rate falls to **36%** if at least **10% of the net baseline amount** is left to a qualifying UK charity.

Estates are divided into **three components**: the general, the survivorship and the settled property components. The 10% test applies to each component separately, but personal representatives can elect within **two years** to merge components, allowing the 36% rate to apply more widely where charitable gifts exceed 10% of the combined value.

Each component is valued after deducting relevant liabilities, reliefs and exemptions (excluding charitable gifts), with a proportionate share of the available nil rate band and any transferable nil rate band applied. The residence nil rate band and transferable residence nil rate band are not deducted when calculating the 10% threshold.

The gift to the UK registered charity is **exempt from IHT**, and the remaining taxable element of the estate can benefit from the **36% rate** where the conditions are met.

36% rate of IHT - example

- £800,000 **free estate.**
- £200,000 **trust interest.**
- £325,000 **nil rate band.**
- £100,000 **transferable nil rate band.**
- £65,000 **charitable legacy** is provided in the will from the residue of the estate.

	General component	**Settled property component**
Value after deducting liabilities, reliefs and exemptions	800,000	200,000
Nil rate band / transferable nil rate band	(340,000)	(85,000)
Baseline	460,000	115,000
10% of baseline e.g. donation required	46,000	11,500

General component qualifies for the reduced 36% IHT rate. The settled property component doesn't have a charitable gift, so it will continue to be taxed at the 40% rate, unless a formal election is made to pool the components together.

This case study is for illustrative purposes only.

36% rate of IHT - planning opportunities

- Deed of Variation could be considered within two years of death to increase donation to charity to meet 10% test.
- May also be better to leave a percentage of value to charity in the will rather than absolute amount.
- HMRC provides a calculator to help work out if estate qualifies for reduced rate.

Agricultural and business relief

For deaths from 6 April 2026, but anti forestalling measures applying to gifts on or after 30 October 2024:

- First £2,500,000 of combined agricultural and business property qualifying for 100% relief will be 100% relieved. Allowance will
  - Be allocated proportionately between qualifying assets.
  - Allowance applies to estate, failed potentially exempt transfers and/or chargeable lifetime transfers.
- Value of qualifying assets over the threshold will be relieved at 50%.
- Effective IHT charge will be 20%.
- Unused £2,500,000 allowance transferable to surviving spouse.

Non-quoted/unlisted shares, such as AIM shares:

- Business relief at reduced rate of 50% from 6 April 2026.
- Will not be included in lifetime £2,500,000 cap.

‘Off the shelf’ trusts with onshore or offshore bond

General rule – greater the access for the person creating the trust, the less IHT efficient.

Increasing access and flexibility for Settlor(s) ↓

- Gift trust (bare or discretionary)
- Discounted gift trust
- Flexible reversionary trust
- Gift and loan (or loan trust)
- Probate trust

↑ Increasing IHT mitigation

Some golden rules of IHT planning

- Starting early.
- Using exemptions every year.
- Not giving away assets that are still needed.
- Maximising spouse exemption.
- Preserving residence nil rate band.
- Keeping good records.
- Understanding ownership of assets e.g. joint, trusts, business assets.
- Reviewing IHT plans regularly.
- Having a valid will.

Thank you. Any questions?

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