Chartered Certified Accountants

WALSH WEST CCA

A GUIDE TO INHERITANCE TAX - INFORMATION FOR CLIENTS

Walsh West Certified Chartered Accountants 2021

Only a small percentage of estates are large enough to incur Inheritance Tax (IHT), but you mustn't forget to factor this tax into your plans when you make your will. Our guide explains what IHT is, how to work out what you need to pay and when, and some of the ways you can reduce this tax.

What is Inheritance Tax?

Inheritance Tax (IHT) is a tax on the estate of someone who has died, including all property, possessions and money. Even if there is no Inheritance Tax to pay, you'll still need to report it to HMRC.

How much is Inheritance Tax?

There is normally no tax to be paid if:

- The value of your estate is below the Nill Rate Band (NRB) of £325,000, or
- You leave everything above the threshold to your spouse or civil partner, or
- You leave everything above the threshold to an exempt beneficiary such as a charity, or
- If you give away your home to your children or grandchildren your threshold can increase to £500,000.

If the value of your estate is above the NRB, then the part of your estate above the threshold might be liable for tax at the rate of 40%.

So, if your estate is worth £525,000 and your IHT threshold is £325,000, the tax charged will be on £200,000 (£525,000 - £325,000). The tax would be £80,000 (40% of £200,000).

The NRB is fixed at £325,000 until 2026, but your NRB might be increased if you're widowed or a surviving civil partner. Couples can transfer any unused NRB when the first person died to the survivor.

This can double the amount of NRB available up to £650,000. This extra transferable element is known as Transferable Nil Rate Band (TNRB).

The Residence Nil Rate Band (RNRB) – also known as the home allowance -has been introduced recently.

The RNRB is on top of the NRB and the TNRB. To be eligible you must pass your home or a share of it to your children or grandchildren. This includes step-children, adopted children, foster children but not nieces, nephews or siblings.

This table shows the increases of the RNRB and the potential combined allowance:

Tax Year	Resident Nil Rate Band (£)	Nil rate band (£)	Combined allowances
2020/21	175,000	325,000	500,000
2021/22	175,000	325,000	500,000

It was announced in the Finance Bill 2021 that Inheritance Tax nil rate bands will remain at existing levels until April 2026. There is tapered withdrawal of the home allowance if the overall value of your estate exceeds £2 million.

Provided certain conditions are met, the home allowance gives you an additional allowance to be used to reduce any IHT liability against your home.

You may also be able to use any unused RNRB from your spouse or civil partner's estate if you're widowed or a surviving civil partner. This can double the amount of RNRB available.

How to value the estate

To value an estate, you will need to:

- List out all the assets and work out their value at the date of death
- Deduct any debts and liabilities

Remember to keep records of how you worked it out, such as estate agent's valuation.
HMRC can ask to see records up to 20 years after Inheritance Tax (IHT) is paid.

Assets include items such as money in a bank, property and land, jewellery, cars, shares, a pay-out from an insurance policy and jointly owned assets.

Gifts also need to be included, such as cash or other assets, if they were given away in the seven years before the person died. You'll also need to include any gifts given before this period if the person who died continued to benefit from the gift. These are also known as 'gifts with reservations of benefit'.

For example, they gave away their house but continued to live in it. Debts and liabilities reduce the value of the deceased's chargeable estate. Think about items such as household bills, mortgages, credit card debts, and, in general, funeral expenses. However, any costs incurred after death, such as solicitor's and probate fees, can't be deducted from the estate's value for IHT purposes. It can be complicated, so it's worth getting advice to help you make the right decisions.

Who pays Inheritance Tax?

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. However, in practice, most IHT is paid through the Direct Payment Scheme (DPS). This means, if the person who died had money in a bank or building society account, the person dealing with the estate can ask for all or some of the IHT due to be paid directly from the account through the DPS.

Sometimes the person who died has left money to pay IHT. Normally this is arranged through a whole-of-life insurance policy, which remains in force until the policyholder's death, as long as the premiums are paid.

Payments from a life insurance policy could be subject to IHT. But, by writing the policy in Trust, the tax should be avoided. This way you also avoid going through the often-lengthy probate process. Once the tax and debts are paid, the executor or administrator can distribute what remains of the estate.

When do you have to pay Inheritance Tax?

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.

Inheritance Tax gifts, reliefs and exemptions

Some gifts and property are exempt from Inheritance Tax (IHT), such as some wedding gifts and charitable donations. Relief might also be available on certain types of property such as farms and business assets. If the person who died gave a gift in the seven years before they died, it's counted as part of the estate, and likely to incur IHT. How much tax is due depends on the value of the gift, when it was given and to whom.

How can I reduce the amount of tax paid?

Trying to reduce how much IHT is due on an estate is complicated. But, in short, you can reduce how much tax is paid by:

- Leaving a legacy to charity
- Putting your assets into a trust for your heirs
- Leaving your estate to your spouse or civil partner
- Paying into a pension instead of a savings account
- Regularly giving away up to £3,000 a year in gifts

Using life insurance to pay Inheritance Tax

Taking out a life insurance policy to pay some or all of an Inheritance Tax (IHT) bill, can make things easier on your family when it comes to sorting out your estate after your death.

It can help protect your home and other assets from having to be sold to pay an IHT bill, which must usually be paid before probate is granted. This gives you the peace of mind you're not lumbering your family and friends with a hefty tax bill to pay when you pass away.

Normally, IHT needs to be paid before probate can be issued. But where property is concerned HMRC may accept staged payments until the property is sold. Alternatively, a bank might release money if it is paid direct to HMRC to pay an IHT bill. A delay in payment can result in HMRC charging penalties and interest on the amount of the inheritance tax which should have been paid.

Most life insurance policies will count as part of the estate unless your policy is written 'in trust' which can often be done at no extra cost when taking out your policy.

This means any money is paid out to your beneficiaries and not to your legal estate. So, any pay-out will not count towards your threshold and won't be subject to IHT. This would avoid a lengthy probate process, so your beneficiaries will get their money much more quickly.

A whole-of-life insurance policy is often used for this purpose, which remains in force until the policyholder's death, provided you continue paying the premiums.

How it works

- You set up an insurance policy.
- You specify the policy is held in trust. If you don't, the money from the insurance pay-out is counted as part of your estate and subject to IHT.
- When you die, the policy pays out to the trust, which might be used to pay all or part of your IHT bill. You might need to set out your wishes in a side letter to guide your policy trust trustees to use the funds in this way.

Estate and tax planning can be complicated, so it's well worth getting advice to help you make the right decisions for your situation.

If you're thinking of using life insurance to pay IHT, there are two types of policy you can take out:

1. Whole of life policy

- This type of policy lasts as long as you live, and generally only pays out when you die, provided you keep up with the premiums.
- If you want this kind of insurance, bear in mind you might be paying premiums well into your 80's and 90's. Premiums are more expensive the older you get however some whole-of-life plans charge fixed premiums for a fixed amount of cover so you know how much the policy costs and the sum assured at the outset.
- You might also find it's difficult to get insured when you're older, or have had health problems.

2. Term insurance policy

If you gift assets away to loved ones other than spouses, there's a risk that if you were to die within seven years, they could be left with a large tax bill. This bill will often fall on the person who received the gift rather than the estate.

- An Inter Vivos policy which is a type of decreasing term insurance policy can provide a lump sum pay-out on death to matching any IHT liability on a potentially exempt transfer over the nil rate band for Inheritance Tax.
- This type of policy lasts a certain amount of time, and only pays out if you die within the stated period. After that period your policy will expire.
- Premiums are usually fixed at the start of the policy

You need to keep up with the premium payments for the duration of either type of policy, so it pays out when you die.

What other taxes do my heirs have to pay on their inheritance?

Your estate is only distributed after debts (if any) and Inheritance Tax (IHT) are paid. Depending on what they inherit, your heirs might also incur:

- Income Tax - if what they inherit produces a regular income (e.g., share dividends or rent from a property)
- Capital Gains Tax - if they sell their inheritance (e.g., property) for more money than what it was worth when you died. How much they have to pay depends on whether they pay Income Tax at the basic or higher rate.

If you've put your assets into a trust or you're thinking about doing this, how much tax and what kind of tax they have to pay can get very complicated.

You should speak to a tax adviser or lawyer for help in working this out. Call us for help.

For advice about Accounting and Taxation, call our team on 0203 488 7503, 01992 236 110 or contact us by email at welcome@walshwestcca.com or via our website www.walshwestcca.com and we will help you.