

## **INHERITANCE TAX**

UK Inheritance Tax applies to the worldwide assets of individuals who are domiciled or are deemed to be domiciled in the UK. In the case of non- UK domiciled individuals, such as Republic of Ireland residents, UK inheritance tax will only apply to assets situated in the UK. UK Inheritance tax will generally only apply to an Irish domiciled individual who has net assets in the UK which exceed £314,000.00. There are special UK rules on domicile for the purpose of UK inheritance tax.

### **Tax on some lifetime Transfers**

UK Inheritance arises principally on assets which pass to others on an individual's death. However Inheritance Tax can also arise on transfers of assets made during an individual's lifetime. To some extent, therefore it is also a tax on lifetime gifts. There are two categories of lifetime transfer.

The first category is where the person making the gift dies within seven years. Where an individual makes an outright unconditional gift and survives by seven years, there is no UK inheritance tax. In fact, generally there will be no tax at all on an outright gift in these circumstances. There will only be tax if the donor dies within seven years and that tax will only be payable at the time of the donor's death. This is different to the case in most countries (including Ireland) where lifetime gifts are taxed in much the same way as benefits inherited on death.

Effectively, UK Inheritance tax "looks back" at lifetime gifts made by an individual in the seven years before his death and adds them back into his total assets for the purpose of calculating the tax. The first £312,000 of value is not taxed and the balance is taxed at death at the rate of 40%. Transfers to spouses are exempt. The £312,000 can be increased to up to £628,000 where an individual's spouse has not used up the full £312,000 allowance.

Where a person makes a lifetime gift and dies more than three years after the transfer, the full death rate (40%) is reduced in so far as it applies to that transfer. The reductions are as follows:

Transfers 3 /4 years before death – 80% of death charge

4 /5 years before death – 60% of death charge

5 /6 years before death – 40% of death charge

6 /7 years before death – 20% of death charge

The above transfers alter the rate of tax payable so do not make any difference if the transfer was within the nil amount.

The second type of lifetime transfer is subject to Inheritance tax immediately. This arises on transfers to certain trusts. The tax on these transfers is at half the normal (40%) tax rate. In the case of lifetime transfers to trusts, the tax rate is therefore 0% on the first £312,000 and 20% on the balance of the value of the assets transferred.

Where a person dies within seven years of making a lifetime gift into trust the effect of the above reductions may be that no tax may be payable. For example, if a person died 4 to 5 years after making a lifetime transfer, the tax is reduced to 40% of the death charge. The death rate is 40% of 40% (16%), so that no additional tax would be payable. The trustees, however, are not entitled to a refund of the 20% tax already paid.

Most outright gifts of assets made by an individual during his lifetime are potentially exempt from Inheritance Tax. This means that as long as the person making the gifts survives seven years there will be no tax. Therefore there is no tax in the UK on an outright gift where the person making it survives seven years.

Prior to 22nd March 2006 it was possible to set up so called “accumulation and maintenance trusts” which had many of the advantages of a trust and which were exempt from Inheritance Tax provided that the person creating the trust survived by seven years. Many such trusts still exist but it is not possible to create new trusts which

qualify for this special treatment. It is still possible to create trusts for certain disabled persons and bereaved minors which receive the favourable treatment.

### **Transfers between husband and wife**

Transfers and inheritances between husband and wife are generally exempt from Inheritance Tax provided both are UK domiciled or both are not UK domiciled. An individual has an Inheritance Tax free from allowance of £314,000.

Prior to 2008 husbands and wives had separate Inheritance Tax allowances. Since that date unused, thresholds are freely transferrable. This means potentially that a threshold of £628,000 is available on the death of a second spouse.

Formerly techniques were used to try to ensure that as many assets as possible passed through each spouses estate. This would typically involve parties putting properties in two names as tenants in common so that (say) half the value transferred down to children on the death of the first spouse and the other (say) half pass down on the death of the second spouse so as to maximise the nil rate in each of the estate. These planning techniques are no longer required.

There is an important exception to the exemption for gifts and inheritances passing between spouses. There is a nil rate / allowance of only £55,000 if the recipient spouse is non UK domiciled but the transferor spouse is UK domiciled.

### **Other Exemptions**

Gifts not exceeding £250 to any one person in any one year are exempt. Transfers of £3,000 per person per year are exempt. Any unused annual exemption can be carried forward for one year. Gifts up to £5,000 per parent are exempt on marriage.

Normal expenditure out of income is exempt. It would have to be part of normal expenditure of the donor paid out of income to maintain the usual standard of living of

another. This is a question of fact in each individual case. This exemption is often used to fund payment of premiums on an insurance policy written by a parent in favour of a child on which the parent pays the premium. It can be also used to pay premiums on insurance to fund potential Inheritance Tax liabilities should the donor die within seven years of a gift. Because these policies are funded by monies exempt from Inheritance Tax, the proceeds are owned by the named beneficiary free from Inheritance Tax.

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This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.