



Inheritance Tax - a basic outline

Inheritance tax (hereinafter referred to as "IHT") is a tax on gifts and death duty. It is a tax that is (in most but not all cases) chargeable on the estate of a person after they have died.

On death the value of a persons estate is calculated. Added to this calculation are any Potentially Exempt Transfers ("P.E.T") which have been made during the seven years preceding death. A P.E.T is an irrevocable gift made during life to an individual. Deducted from this cumulative total is the nil rate band. (Presently £255,000.00 from the 6th April 2003) The final figure left is then taxable at 40%.

1 Exempt Transfers

Certain transfers are classified as exempt transfers. Such a transfer will not invoke any IHT liability. (The following list is not exhaustive)

1.1 Normal Expenditure out of Income

A lifetime gift is exempt if it is shown that the gift was made as part of the normal expenditure and it comes out of income rather than capital. The gift must be normal in that the donor has the habit of making such gifts, and it must be shown that there was a habit of making such gifts out of income. Therefore a person may use income to pay life insurance premiums for another person. Another example is to make regular payments into a savings plan for another

1.2 Small Gift Exemption

Any number of gifts of upto £250.00 in any one tax year are exempt. Caution must be exercised not to exceed the allowance in any one year or the exemption is lost.

1.3 Annual Exemption

There is an annual exemption of £3,000.00. This exemption can be carried forward for one year if it is not used. This exemption is a total for a year and not per recipient!

1.4 Gifts to Charity

These are totally exempt.

2 Potentially Exempt Transfers (P.E.T's)

This is one of the main ways in which a person can avoid the burden of tax on death. The P.E.T is a lifetime transfer of money or property to another individual (or to an accumulation and maintenance trust). If a person lives for more than seven years from the date of the transfer the gift becomes totally exempt from IHT.

Care must be exercised in making gifts during life and the following points must be considered:-

2.1 The transfer of a chargeable asset may result in a Capital Gains Tax liability. So for example transferring share in a company that have increased in value.

2.2 There can be no reservation of benefit. An asset disposed of will be treated as belonging to the donor on death if the donee did not assume the benefit and the donee retained control and enjoyment. In other words the donee must assume enjoyment of the asset and this is virtually to the exclusion of the donor. A typical example might be a person giving a house to a child but retaining the right to rent or occupation. There is an exemption in relation to property if the person making the gift pays a full market rent to the donee.

2.3 The transfer leaves the donor with insufficient funds.

2.4 A gift can be made to a person who loses control during your life. Typical examples are death bankruptcy and divorce. Always consider carefully the needs and position of the recipient before making a gift.

The reason why a P.E.T. is attractive is that although a person must live for 7 years after the gift to gain a total exemption there is a taper relief

There are certain other exemptions such as Business Property Relief which may apply and you should seek advice.

Finally always remember laws change. What may seem good today may change in the future. Please always keep things under review and seek advice regularly

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