**Inheritance Tax Guide**

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Inheritance Tax (IHT) can be paid following your death on the value of your estate. Your solicitor will be able to advise you in more detail about this and importantly can relate this advice to your particular circumstances. We have tried to provide a general explanation below about how IHT works in relation to estates which include charitable gifts.

**The IHT threshold – the nil rate band**

If the total value of your estate is under £325,000 there should be no IHT to pay unless you have made qualifying lifetime gifts or have benefitted from qualifying trust funds.

If the total value of your estate is over £325,000 IHT will have to be paid from your estate, generally at 40%, on any amount over £325,000 unless there are exemptions available.

***Example 1***

If your estate is worth £400,000 at the date of death and no further exemptions are available, then the IHT payable would be calculated as follows:

£400,000 - £325,000 = £75,000

£75,000 x 40% = £30,000 IHT liability

This means that if your estate is worth over £325,000, your beneficiaries will only keep £6,000 out of every extra £10,000 that you leave.

Gifts to charities, your spouse or civil partner in your Will are generally exempt from IHT. If you leave a gift to any of these, their value will be deducted from your estate before IHT liability is calculated.

***Example 2***

If at the date of death your estate is worth £400,000 and the whole estate is left to your spouse or civil partner or charity, then your whole estate will pass free of tax under spouse/civil partner or charitable exemption.

***Example 3***

If at the date of your death your estate is worth £400,000 and 50% passes to charity and the remaining 50% passes to a non-exempt beneficiary (a friend for example), then the £200,000 passing to charity will be free from IHT and the £200,000 passing to your friend will also be free from IHT as this amount is within your £325,000 nil rate band.

***Example 4***

If at the date of death your estate is worth for example £800,000 and you leave 40% to charity (£320,000) and 60% (£480,000) to non-exempt beneficiaries, then your estate will potentially be taxable. The IHT liability would be calculated as follows:

£800,000 - £320,000 = £480,000

£480,000 - £325,000 = £155,000

£155,000 x 40% = £62,000 IHT liability

Because of the way the tax rules work, this IHT liability would usually be paid solely from the non-exempt beneficiaries’ share of the estate. The charity would therefore receive the £320,000 and the non-exempt beneficiaries £418,000.

**The 10% IHT charity relief**

You may also have heard, if you leave over 10% of your net estate to charity, that the rate of any IHT due would be reduced from 40% to 36%. If your estate is over £325,000, use of this could enable you to leave a legacy to charity, reducing the rate of IHT payable and possibly have a positive impact on non-charity beneficiaries. In some circumstances you can use this to leave a gift to charity at no cost to the other beneficiaries in the Will.

***Example 1*** below shows how beneficial it can be to charities, to increase a charitable gift from 4% of the net estate to satisfy the 10% test.  Here, the gross estate is worth £450,000 and the £325,000 nil rate band has been deducted, leaving a net taxable estate of £125,000.

|  |  |  |  |
| --- | --- | --- | --- |
| **Charitable gift** | **4% (£5,000)** |  | **10% (£12,500)** |
| **Estate worth** | £450,000 |  | £450,000 |
| **After £325,000 nil rate band deducted** | £125,000 |  | £125,000 |
| **Percent of IHT due** | 40% |  | 36% |
| **IHT has to be paid on** | £120,000 |  | £112,500 |
| **Amount of IHT liability** | £48,000 |  | £40,500 |
| **Estate balance for distribution to beneficiaries** | **£397,000** |  | **£397,000** |
| **Estate balance for distribution to charity** | **£5,000** |  | **£12,500** |

***Example 2*** illustrates how a deed of variation made by executors increasing the charitable gift by a mere £2,500 from £10,000 to £12,500 (10% of the net estate), can increase both the legacy to charity and beneficiaries. Again, the gross estate is worth £450,000 and the £325,000 nil rate band has been deducted.

|  |  |  |  |
| --- | --- | --- | --- |
| **Charitable gift** | **£10,000** |  | **£12,500** |
| **Estate worth** | £450,000 |  | £450,000 |
| **After £325,000 nil rate band deducted** | £125,000 |  | £125,000 |
| **Percent of IHT due** | 40% |  | 36% |
| **IHT has to be paid on** | £115,000 |  | £112,500 |
| **Amount of IHT liability** | £46,000 |  | £40,500 |
| **Estate balance for distribution to beneficiaries** | **£394,000** |  | **£397,000** |
| **Estate balance for distribution to charity** | **£10,000** |  | **£12,500** |

As you can see, increasing a charitable gift in this way can lead to a substantial inheritance tax saving benefiting the charity involved. This could also potentially lead to an inheritance tax rebate from HM Revenue and Customs where a Will has been varied within the two-year time limit for Deeds of Variation and inheritance tax has already been paid on the estate.

Again, this is quite a technical provision and, if it is of interest to you, we would suggest that you speak to a solicitor. Changes to the IHT allowance or the value of your estate could make a big difference to the amount of tax on your assets, and tax rules do change, so be sure to review your Will frequently.

***Disclaimer: This briefing is intended to highlight issues only for the purpose of general interest and is not intended to be a comprehensive statement of the law. Although we have taken care over the information, you should not rely on it as legal advice. We do not accept any liability to anyone who does rely on its content. Last updated: April 2018.***