

Quick Guide to Inheritance Tax Planning

Inheritance Tax planning – your questions answered. June 2010

Over the last few years there have been many changes to the Inheritance Tax (IHT) system which have brought a great deal of confusion. The following Q&A should explain how the latest inheritance tax changes may affect you.

I always thought I could leave whatever I like to my spouse without paying inheritance tax

Yes, provided you are both domiciled in the United Kingdom you can still leave all your assets to your spouse, whatever they are worth, without him/her incurring inheritance tax – the change relates to the tax free amount you and your spouse can ultimately leave to your beneficiaries.

Please note: Special rules apply if either you or your spouse is not domiciled in the United Kingdom. The rules on domicile are fairly complex, particularly as it is possible to be a UK national and be domiciled in another country. If either you or your spouse were born outside the UK, spend significant time abroad or have any other links with foreign jurisdiction, then these special rules may apply to you and as a result you may not be able to claim the full spouse exemption.

So what do the main changes to the Inheritance Tax mean?

In the past married couples and those in civil partnerships could transfer an unlimited amount to each other when one died, without paying IHT. When the surviving spouse or partner died, their estate had to pay 40% tax on their estate above the IHT threshold, currently £325,000. If the first person to die had left everything to the other, they would not have used their nil-rate band. Many clients therefore set up Wills including Special Discretionary Trusts to ‘use’ the nil-rate band of the first to die, while still protecting the surviving spouse.

The changes mean that couples can transfer their £325,000 allowance to each other, with the result that when the second person dies, the two allowances are added together and tax is only paid on amounts above the combined allowance (presently £650,000). This is often called ‘the Transferable Nil Rate Band’ and in a nutshell the changes relate to the amount of tax free money couples can leave to their beneficiaries.

Who can benefit from the ‘Transferable Nil Rate Band’?

This change is for married couples and those in civil partnerships but not single people or those who cohabit, even if they are blood relations. However, if you are cohabiting, you both have an individual allowance of £325,000 and so you will collectively be able to pass on £650,000 tax free to children or other nominated beneficiaries, but you cannot leave assets of more than £325,000 to each other or anyone else without paying inheritance tax. It’s something to consider if you have a large estate or valuable property.

I was widowed before these changes took place, so can my heirs benefit?

Yes, your heirs can benefit because the government has backdated the tax benefits so however long ago you were widowed, your executors can still use the ‘Transferable Nil Rate Band’. But one word of warning, you need to check that your spouse did not leave significant gifts elsewhere, for example to your children or grandchildren, as these gifts will

be deducted from the nil-rate band at the time of their death and only the unused percentage can be added to the nil-rate band of the second to die.

When we made our new Wills my spouse and I included nil-rate band Discretionary Trusts to make the most of our IHT allowances, what should we do now?

If it's a nil-rate band discretionary trust that you made simply to use your and your spouse's nil-rate band, then it may be obsolete now and you should have new Wills made without these trusts. But of course it may not be simple as other factors may have to be taken into account.

When might I want to keep the trust I have set up?

Despite the changes, trusts can still have an important role to play in many people's estate planning. For example you may want to ensure that money is passed on to children or grandchildren from a previous marriage. Or you may use a trust to reduce your family's liability to meet with residential care home fees. Or you may wish to have a large estate managed on the behalf of your spouse.

My spouse has died; can I alter the terms of a trust set up on his death?

If your spouse died less than two years ago, then it may be possible to alter the trust or wind it up altogether. However, if your spouse has been dead for a longer period, then you will not be able wind up the trust and benefit from the Transferable Nil Rate Band.

How can you calculate what the two allowances are worth if the survivor lives long after the tax allowance goes up?

The calculation will be made at the time when the second person dies. Put simply, the beneficiaries will be able to add together the unused allowance of the first to die. For example if the second person dies in 2010, then the estate will only pay tax on anything above £650,000, if neither had used any of their nil-rate band allowance.

My remaining parent died in September 2007, leaving an estate of £650,000, can I benefit from these changes?

Unfortunately not, as the changes only apply to IHT liabilities on or after Tuesday 9th October 2007.

Remember that gifts made in the 7 years (and in certain circumstances in the 14 years) before death, are added to the value of the estate for calculating Inheritance Tax.

If you are at all unsure about how these changes will affect your affairs, then do call our experts for advice and visit our website at www.phillips-law.co.uk



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