



Legal Brief

Inheritance Tax planning – your questions answered. February 2009

Changes in inheritance tax (IHT) rules made by the government over many years have brought a great deal of confusion. The following Q&A should explain how the latest inheritance tax changes, particularly those introduced in October 2007, may affect you.

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

Yes, you can still leave all your assets to your spouse (if UK domiciled), whatever they are worth, without him/her incurring inheritance tax – the change relates to how the tax free nil-rate band (NRB) amount of you or your spouse can best be left to your beneficiaries.

So what do the latest changes to the inheritance tax mean?

Married couples and those in civil partnerships can transfer an unlimited amount to each other without paying inheritance tax. Under the previous rules, when the surviving partner died, their estate had to pay 40% tax on their estate above the IHT threshold, currently £312,000. If the first person to die had left everything to the other, that person would not have used their nil-rate band. Many clients therefore set up Wills including Discretionary Trusts to 'use' the nil-rate band of the first to die, while still protecting the surviving spouse.

The 2008 changes mean that when the second person dies, the percentage of the nil-rate band allowance unused on the first death can be claimed by executors of the second to die, as well as that second person's allowance. Tax is only paid on amounts above the combined allowance at a single rate of 40%.

Who can benefit from this arrangement?

This relates to married couples, widows, widowers and civil partners but not single people or those who cohabit, even if they are blood relations. If you are cohabiting, you both have your individual allowance of £312,000 and so you would collectively be able to pass on £624,000 tax free to children or other nominated beneficiaries if you left them the full allowance on each death. You cannot leave assets of more than £312,000 to each other or anyone else without paying inheritance tax, which is 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 your late spouse's unused nil-rate band. But one word of warning, you need to check that your spouse did not leave significant gifts elsewhere, for example to 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 of the nil-rate band can be added to the nil-rate band of the second to die. Certain documents have to be produced to prove the percentage of unused nil-rate band.

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, so it is important to take legal advice.

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 deaths on or after Tuesday 9th October 2007.

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. You may need a trust structure to ensure that assets are managed for minors until they come of age, 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 under his Will?

Unfortunately it may prove impossible to alter the terms of the trust, even with the consent of all the adult beneficiaries, as trusts are set up to protect the interests of all beneficiaries. However, if your spouse died within the last two years, changes may be possible even if the trust has been set up, but specialist advice is needed to ensure that you do not inadvertently increase your inheritance tax liability.

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 executors will be able to add together the unused allowance of the first to die, plus that of the second to die. For example if the first person died in 1998 and 40% of their estate was given to their children with the rest going to the other partner/surviving spouse. On the death of the surviving partner/spouse in 2008, that person's executors can claim the whole of their nil-rate band plus an extra 60% from the estate of the first person who had died – a total of £499,200.

Footnote:

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.

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