



Legal Brief

Inheritance Tax planning – your questions answered. October 2007

The recent changes in inheritance tax (IHT) treatment made by the government 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, 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.

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 inheritance tax. But when the surviving partner died, their estate had to pay 40% tax on their estate above the IHT threshold, currently £300,000. 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 £300,000 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 £600,000). In a nutshell the changes relate to the amount of tax free money couples can leave to their beneficiaries.

Who can benefit from this new 'couple's allowance'?

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 £300,000 and so you will collectively be able to pass on £600,000 tax free to children or other nominated beneficiaries, but you cannot leave assets of more than £300,000 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 'couple's allowance'. 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 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 on his death?

Unfortunately it may prove impossible to alter the terms of the trust with the consent of all the beneficiaries, even if there might be infant beneficiaries, as trusts are set up to protect the interests of all beneficiaries. If the terms were changed in your favour for example, there would in theory be nothing to stop you buying a Ferrari and a villa in the sun! However, if your spouse died within the last two years, changes are possible even if the trust has been set up.

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 after 2011, when the allowance rises to £350,000, the estate will only pay tax on anything above £700,000, if neither had used any of their nil-rate band allowance.

My remaining parent died in September, 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 this year.

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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