



This briefing focuses on two important Inheritance Tax (IHT) planning issues, namely:

- ensuring that a Will is in place; and
- using what is known as the IHT nil rate band.

One planning strategy conventionally used has been to ensure that each spouse or civil partner was able to use their IHT nil rate band on their death. Proposals which were announced in the Pre-Budget Report in October 2007 have significantly altered that strategy in many cases and the purpose of this briefing is to explain the significance of those changes.

Are you Will-ing to plan for IHT?

Generally, everyone is entitled to an IHT exemption when they die, known as the nil rate band (see table below). In theory, this means that a married couple or civil partnership have two nil rate bands between them. However, as will be illustrated, it is not always as straightforward as that.

| IHT nil rate bands | |
|--------------------|---------|
| Tax year | £ |
| 2007/08 | 300,000 |
| 2008/09 | 312,000 |
| 2009/10 | 325,000 |
| 2010/11 | 350,000 |

In addition, the growth in the value of houses in the UK over the past few years (notwithstanding the current slowdown in the market) has caused the combined estates of many couples to rise above the nil rate band. The value of homes plus other significant assets means that IHT planning is now more important for couples who would not necessarily think of themselves as wealthy.

Why bother with a Will?

It is important to stress that writing a Will is something which everyone should do. Apart from the opportunity of undertaking effective tax planning, the absence of a Will can mean that your assets do not pass to those that you would want to have them. Where a person dies without a Will they are said to die 'intestate' and the law prescribes how the estate is to be distributed.

The rules are quite complex and depend on whether the deceased was married or unmarried, or a member of a civil partnership, at the time of their death and whether or not they had children. The rules are not common across the United Kingdom, with Scotland and Northern Ireland having their own sets of rules.

The most important thing to note is that, for couples who are not married or in a civil partnership, there is no right to anything on the death of a partner under

the intestacy rules, so it is vital that they have Wills to protect the financial position of the survivor.

IHT transfers between spouses or civil partners

The IHT rules have always provided that where assets pass on death from one spouse or civil partner to the survivor, the transfer is exempt from IHT irrespective of the amount involved. So if the whole estate passed on the first death, the estate of the first spouse or civil partner would not use any of the IHT nil rate band and, on the second death, the IHT bill would be higher than it needed to be.

Duncan died in August 2003 and left all his £600,000 estate to his widow Eunice. When she died in May 2007 the estate totalled £800,000. The IHT payable on the combined estate would be nil on Duncan's death and £200,000, being (£800,000 - 300,000) x 40% on Eunice's death.

IHT planning for the couple would have concentrated on using the nil rate band on Duncan's death, by leaving up to the amount of the nil rate band to either the children or into a trust arrangement. This would have potentially saved a considerable amount of IHT (at today's rates, £300,000 x 40% = £120,000!).

So what has now changed?

The Chancellor announced in his Pre-Budget Report in October 2007 that, with effect from 9 October 2007, where the surviving spouse or civil partner dies, their estate may be able to claim an additional nil rate band. This will depend on the proportion of the nil rate band that was used on the death of the first spouse or civil partner. This means that, in a simple case, where all the estate passed from the first spouse or civil partner to the survivor, the estate of the survivor will effectively have two nil rate bands available.

Client Briefing

If we return to the example of Duncan and Eunice and simply change the date of her death to December 2007, the situation changes dramatically. Duncan did not use any of his nil rate band and so, on Eunice's death, the total nil rate band available becomes £600,000 and the IHT bill will drop from £200,000 to just £80,000, being $(£800,000 - £600,000) \times 40\%$.

For the surviving spouse or civil partner, it will be important to ascertain what happened on the death of the first spouse or civil partner, no matter how long ago that event occurred. HM Revenue and Customs will want evidence when the IHT Account is made on the death of the survivor. They have stated that as well as wanting to know the proportion of the nil rate band which was not used, they will want basic information such as the marriage or civil partnership certificate of the couple, the Will or Probate details of the first to die, as well as details of any variation of their Will.

In the future it will be important on the first death to retain all that information so that the evidence is available at the time of the second death.

What if the survivor has been married more than once?

If the surviving spouse or civil partner has remarried after the death of their first spouse or civil partner, and then their second spouse or civil partner dies, the rules will only allow a maximum of one extra nil rate band to be used.

So do we need to do any IHT planning now?

It would be easy to assume that a married couple or civil partnership can now leave all their estate to the survivor, knowing that two nil rate bands will be available on the second death and that no specific planning needs to be undertaken on the first death. This is certainly going to be the case where the combined estate is at or about the current nil rate band.

Felicity and Gerald are married and live in a property which is currently worth £250,000. They have savings of another £100,000. The combined estate is just above the current nil rate band and they may have been advised to undertake planning to use some of the nil rate band on the first death. Now they can leave their estates to each other on the first death because they have sufficient leeway with two nil rate bands (£600,000 currently) unless the value of the property increases by a substantial amount.

They should ensure that they write Wills and they should always keep their position under review to ensure that the value of their combined estates fall within the two nil rate bands.

Planning is still likely to be needed where the joint estate is currently at or above the level of two nil rate bands and there is some significant property owned by the couple. The danger in simply leaving everything to each other is that property price growth could easily outstrip the growth in the IHT nil rate band and leave a tax problem on the second death.

Helen and Ian are married and live in a property currently worth £500,000. They have savings of £100,000. The combined estate is just on the double nil rate band level. They decide to leave everything to each other. Ian dies in 2010 when the value of property has risen overall by say 10%, so the house is now worth £660,000 and the cash is still £100,000. There is no IHT payable on Ian's death but all the assets now fall into Helen's estate.

Helen dies in 2012 when the IHT nil rate band is, say, £380,000 and the value of the property has risen to £720,000. The total estate will be £820,000 and the IHT nil rate bands available will total £760,000 $(£380,000 \times 2)$. This will leave a tax bill of £24,000 payable on Helen's death, being $(£820,000 - £760,000) \times 40\% = £24,000$.

If some planning had been done on the first death by, for example, leaving an interest in the property to a trust, then the same proportion of the growth in the value of the property would have been outside Helen's estate and it is likely that the tax charge on her death would be significantly reduced if not removed all together.

Where the joint estate of the couple is already above the aggregate of two nil rate bands then IHT planning should always be given serious consideration at the earliest opportunity.

Planning with business assets is vital

Some assets, such as shares in an unquoted trading company, carry important reliefs for IHT. Known as Business Property Relief (BPR) and Agricultural Property Relief (APR), these reliefs can be up to 100% of the value of the assets concerned. It is important that those reliefs are preserved in Will planning by ensuring that the assets concerned are not left directly to the surviving spouse or civil partner if at all possible. Such a transfer would be exempt and if the survivor subsequently decided to dispose of the asset concerned the relief would be lost completely.

To sum up

Ensure that you have an up to date Will that reflects your personal wishes in terms of who you would like to benefit. This is particularly important if you and your partner are not married or members of a civil partnership.

IHT planning should always be done on a personal basis because every estate is different and every family has its own particular circumstances and requirements. The new provisions in respect of nil rate bands are going to be helpful in many cases but it is dangerous to assume that they will cover every situation.

Planning for IHT can be complex and can require much advance planning. Please get in touch with us if you would like to talk about any IHT planning concerns that you might have.

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