



## Information Sheet: Inheritance Tax update 2008

In the Autumn of 2007, there was a certain amount of political point scoring in respect of Inheritance Tax. Firstly, the Conservatives announced that if they were to win the next election they would look at increasing the Nil Rate Band to £1m. This obviously went down well with voters as the opinion polls showed. In response, the Chancellor announced in his October Pre-budget Report, that the Nil Rate Band for married couples would be doubled to £600,000 in the current tax year with immediate effect and to £700,000 by 2010. This was presented as a substantial tax advantage.

The actual effect of the announcement is that from the 9<sup>th</sup> October 2007, the Nil Rate Band allowance is transferable between spouses and civil partners. The actual legislation was introduced in the Finance Bill in 2008.

It is important to point out that it is the percentage of any unused proportion of the Nil-Rate Band of the first to die that is transferable to the estate of the second to die.

### Example 1:

Husband died in March when the Nil-Rate Band was £300,000, leaving the Nil-Rate Band to a Discretionary Trust, the remainder of his estate to his wife. The widow dies in 2010 when the Nil-Rate Band is £350,000. As her late husband's full Nil-Rate Band allowance was fully used up on his death, her Nil-Rate Band allowance will remain £350,000. Anything above this threshold will be taxed at 40%.  
£650,000 has been sheltered from tax.

### Example 2:

In the same situation as referred to above, if on the husband's death he had actually left a legacy of £150,000 to his son, the remainder of his estate to his wife, then 50% of his Nil-Rate Band threshold was left unused. The unused proportion is transferred to the widow's estate and on her subsequent death in 2010, the Nil-Rate Band in force at that time is increased by 50% of £350,000 (i.e. £175,000) to £525,000. The amount of her estate above this limit is taxed at 40%.  
£675,000 has been sheltered from tax.

### Example 3:

If, in the same scenario, the husband had left his entire estate to his wife and had not used his Nil-Rate Band allowance then on the widow's subsequent death in 2010 as a 100% of his Nil-Rate Band allowance was unused her Nil-Rate Band of £350,000 will be increased by the same amount i.e. 100% of £350,000 to £700,000. The amount above this will be taxed at 40%.  
£700,000 has been sheltered from tax.



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Any relief will need to be claimed by the Executors of the surviving spouse's estate and must be made within two years of the death of the survivor.

The Chancellors announcement was not really a tax break given by the Government as people have always been able to utilise their Nil-Rate Band by putting in place tax efficient Wills.

Many people put in place Wills which included a Nil-Rate Band legacy to a Discretionary Trust to not only mitigate Inheritance Tax but to provide provision and protection for the surviving spouse.

### **Some Advantages of Retaining a Nil-Rate Band Discretionary Trust Will**

If it is envisaged that business or agricultural assets were going to pass into the Discretionary Trust then it is likely to be a good idea to retain such provisions.

If spouses have reservations about passing all assets to the survivor, for example if there are children from previous marriages or concerns over the survivor re-marrying, the Trust can still be of benefit as an estate preservation tool.

Any assets held within the Trust should not form part of any assessment should the survivor need to go into a Residential Care Home.

If it is thought that any assets that were going to go into the Trust would increase in value at a greater rate than the Nil Rate Band then it may be beneficial to keep this growth outside of the survivor's estate.

In most cases it is thought that on the death of the survivor the Discretionary Trust would be wound up and the assets appointed out to the children. However, if the children have Inheritance Tax concerns of their own then the Trust can remain in existence or additional Trusts created so that the assets protected within the Trust would not form part of the children's own estates for Inheritance Tax calculation purposes. This way they would have their own Inheritance Tax allowances and also benefit from the assets in the Trust not forming part of their estate.

If the Trust were retained it could be dealt with accordingly to shelter the Nil-Rate band Allowance



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### A Tax Disadvantage of Retaining a Nil Rate Band Discretionary Trust Will

This is best shown with an example. Husband has assets of £500,000. Wife has assets of £500,000.

Husband died in March leaving the Nil-Rate Band worth of assets to a Discretionary Trust remaining assets to his widow. On the rates of tax in March, £300,000 worth of assets goes to the Trust, £200,000 to the widow.

The widow dies when the Nil-Rate Band is £350,000. Her estate is £700,000.

Her husband used up his Nil-Rate Band allowance so there is no transfer. Her estate is £350,000 above the Nil-Rate Band at her death and taxed at 40% giving a liability of £140,000.

Going back, if when the husband died he left his entire estate to his widow then, on her subsequent death, her husband's Nil-Rate Band allowance was 100% unused and uplifts her Nil-Rate Band allowance at her death by 100% to £700,000.

Her estate which stands at £1m less the uplifted Nil-Rate Band allowance is £300,000 above the Nil-Rate Band and taxed at 40% gives a liability of £120,000.

This example shows that where a married couple have joint estates in excess of the married couple's joint Nil-Rate Band allowance, it can be more advantageous for Inheritance Tax purposes for Wills to leave everything to the surviving spouse.

The examples do not take into account asset growth either within the Trust after first death or of the survivors retained assets.

### How do I take out the tax planning measures in my Will?

By executing a Codicil deleting the provisions relating to the Trust or legacies.

Alternatively, if any Nil-Rate Band Discretionary Trust remained in a Will, then on the death of the first person a decision could be made whether or not to keep the Trust at that stage, for any or other of the above reasons, therefore providing extra flexibility. If it was felt it was not required then assets would notionally pass to the Trust and would then be appointed out to the surviving spouse. If this is done within two years of the death of the first spouse, it is read back into their Will and is treated as if the Nil Rate Band allowance was unused.



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### How can we help?

It is important to review your existing Will, financial circumstances and views on any Inheritance Tax planning and family matters.

There is certainly no single solution for all clients as every client's circumstances are treated individually.

If you wish to review your arrangements then please contact us.

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If you need any further information about matters in this information sheet, please do not hesitate to contact us.