

Inheritance Tax Improvement

The following article is an extended version of the article in our January 2008 edition of *Insight*.

In our July 2007 edition of *Insight - Inheritance Tax Special*, we commented on the apparent lack of political will for making improvements to an Inheritance Tax regime that has seen an ever increasing number of families potentially affected. In October, the Tories announced a headline proposal for the “election that never was” to increase the Inheritance Tax Nil Rate Band to £1million. A week later, Labour retaliated by enhancing the Nil Rate Band on the survivor’s death in a married or civil partnership couple where it has not been fully utilised on first death. This has been loosely described as a doubling-up of the Nil Rate Band which is not entirely accurate and this article aims to explain the change.

The change has, in many ways, simplified a process that was already available for couples employing an Inheritance Tax planning strategy within their Wills. Many couples have set up a Trust within their Wills that sees part of their wealth, up to the Nil Rate Band, enter the Trust on the first of them to die and thereby using the Nil Rate Band rather than losing it. The change in law, effective from the 9th October 2007, means that the Nil Rate Band of the first spouse to die is available on the death of the surviving spouse, achieving broadly the same as has been achieved with Nil Rate Band Discretionary Will Trusts.

This change in law is surprisingly generous in the sense that it applies to married couples even when the first spouse has already passed away. For widows and widowers who die on or after the 9th October 2007, and where their spouse had left everything to the surviving partner, the Nil Rate Band effectively doubles from £300,000 to £600,000. On an Estate valued at £600,000, that is a tax saving of £120,000 (being 40% of the £300,000 above the Nil Rate Band which would otherwise have been payable).

Where the Nil Rate Band was partly used on first death, the percentage of unused Nil Rate Band can be applied to the Nil Rate Band occurring in the year of death of the surviving spouse.

The executor’s of the survivor’s Estate must claim the enhanced Nil Rate Band within two years of the survivor’s death. The maximum enhancement is 100%.

Let us look at a few examples.

1. Mr Example died in September 1996 when the Nil Rate Band was £200,000. He made various bequests totalling £50,000 to friends and family but left the bulk of his Estate to his surviving spouse. No Inheritance Tax was payable on first death.

At the time, it looked as though he had wasted three quarters of his Nil Rate Band, with only a normal Nil Rate Band available to the surviving spouse. However,

Mrs Example dies in October 2008 when the normal Nil Rate Band is £312,000. The Nil Rate Band available to her Estate in respect of Mr Example's Nil Rate Band will be £312,000 x 75% + her own £312,000, making a total of £546,000.

2. Mr Forinstance died in August 1994, when the Nil Rate Band was £150,000. He left all of his Estate to his surviving spouse. So 100% of his Nil Rate Band was unused on first death. Unfortunately, Mrs Forinstance died in May 2007, prior to the pre-Budget report on the 9th October 2007. She will therefore be unable to benefit from the enhanced Nil Rate Band proposed in the pre-Budget speech. Her Estate will therefore only have a Nil Rate Band of £300,000 available. Had she died on or after the 9th October 2007, she would have had a Nil Rate Band of £600,000.

What Happens When The Surviving Spouse Remarries?

If a survivor remarries, she will still be entitled an enhanced Nil Rate Band on death, the enhancement depending on a percentage of unused Nil Rate Band on the death of the first spouse. If that survivor doesn't use all of that enhanced Nil Rate Band, her surviving spouse will have an enhanced Nil Rate Band.

Where a widow has remarried, it is worth checking the available Nil Rate Band, as it may prove beneficial to utilise her Nil Rate Band in the event that she predeceases her new spouse. As the enhanced Nil Rate Band is only available up to 100% of the normal Nil Rate Band, this could see more assets transferring to beneficiaries free of Inheritance Tax than if all assets simply passed to the surviving spouse.

What To Do If You Already Have A Discretionary Nil Rate Band Will Trust In Place?

If your Will includes Discretionary Nil Rate Band Will Trusts, it would be good to review them. One of the key issues to consider is the wording used to describe the amount that is placed within the Discretionary Will Trust. Consider, for example, a widow who has remarried whose previous husband had used none of his Nil Rate Band. If the widow subsequently dies, her Will might refer to "an amount equal to the Inheritance Tax Nil Rate Band applicable at the time of my death, less any chargeable transfers, including failed Potentially Exempt Transfers, made by me within seven years of my death" to be placed in a Discretionary Will Trust.

If she dies now, in the tax year 2007/2008, the Nil Rate Band, at the time of her death, would be £300,000, even though she now has the ability to double her Nil Rate Band. Therefore, even if she had previously no Chargeable Transfers or Potentially Exempt Transfers, only £300,000 would be placed in the Discretionary Will Trust. Had the wording been along the lines of "the maximum amount that could be transferred if it were to be wholly chargeable to Inheritance Tax at the rate of 0%", up to £600,000 could be placed into the Discretionary Will Trust.

Existing Wills which already use the Nil Rate Band on first death are still perfectly valid and, indeed, can, in some circumstances, be a better option than an enhanced Nil Rate Band on second death. For example;

- The assets held in the Trust may increase at a faster rate than the increase in the Nil Rate Band. However, with many commentators anticipating poor growth in residential property, if the asset held in the Trust is the home then this may be a reason to consider not invoking the Discretionary Will Trust.
- Using the Discretionary Will Trust on first death can reduce the surviving spouses Estate for the purpose of means testing in long-term care issues.
- Where remarriages are concerned, it may still be wise to use the Nil Rate Band on first death in the later marriage because of restrictions in the enhanced Nil Rate Band.

What Should Be Reviewed?

It would be sensible to review your existing Inheritance Tax plans and your Wills, although you may not necessarily wish to make any changes. Whole of life policies in Trust may no longer be needed to fund an Inheritance Tax bill on second death but the proceeds would be welcomed by the family.

A portfolio of shares in the Alternative Investment Market may now be an inappropriate level of risk if no longer needed for Inheritance Tax planning.

All the Inheritance Tax planning strategies mentioned in the July 2007 newsletter remain valid where Inheritance Tax planning remains an issue. If you would like a copy of the July 2007 newsletter or if you have any other questions related to your Inheritance Tax plans, please get in touch.