

Inheritance Tax

***Former Chancellor of the Exchequer, Roy Jenkins, once said
"Inheritance tax is a voluntary levy paid by those who distrust their heirs
more than they dislike the Inland Revenue."***

You would be amazed at how much money is paid out to the taxman because people don't always plan properly. This can be upsetting for relatives and all too often the bulk of the tax could have been lowered.

After you die there are two rates of Inheritance Tax (IHT) charged on your total personal estate. 0% (Nil) up to £312,000* which is called the nil-rate band and at 40% on everything over this amount. That's nearly half! It could pay off someone's mortgage or maybe put the children through university. **Be Aware!** Not only is your UK property taken into account but also any foreign properties.

**From April 2008. Rising to £325,000 in year 2009/2010*

No tax is paid on assets transferred between married spouses or civil partners on death, but this is not the case for unmarried partners, no matter how long they have been together or whether they had children.

There are a number of ways to avoid, or limit your liability:

- Potentially Exempt Gifts (PETs) - You can give lifetime gifts of any amount and as long as you survive for seven years after making a PET, the asset is not considered as part of your estate and is therefore exempt from IHT. If you do die within the seven year period, there is a sliding scale of tax reduction which comes into force after the third anniversary of the PET.
- Exempt Gifts - Small amounts can be given away each year and the current limits are up to £250 to as many people as you wish or up to £3000 for any one gift (not to any person in receipt of a £250 gift).
- Gifts in consideration of marriage - Certain Exempt Gifts can be given to couples on marriage. Each parent can give £5,000, each grandparent £2,500 and anyone else may give up to £1,000.
- Gifts to Charities or the main political parties established in the UK, are exempt from Inheritance Tax.
- Gifts and bequests made to certain bodies concerned with the preservation of the national heritage or of a public nature are exempt.
- There are exemptions and reliefs for particular types of property (business), agricultural land, woodlands, works of art and historic houses.

Remember all gifts must be an outright gift. Both partners can make the gifts, but watch out for any Capital Gains Tax which may be due.

Married Couples, Civil Partnerships, Widows and Widowers

On 9th October 2007, in his pre-budget statement, the Chancellor of the Exchequer announced far reaching changes to the way Inheritance Tax (IHT) will be charged on the estates of married couples or civil partnerships. The announcement introduces the concept of a transferable nil-rate band between spouses and civil partners. This is effectively a way to allow a couple to enjoy the benefit of two nil-rate bands. The amount of the additional nil-rate allowance will be the proportion of unused allowance at the time of the first death, calculated as a percentage, and then applied the allowance applicable on the second death.

EXAMPLE: Mr. Smith dies leaving £150,000 to his son and the balance of his estate to his wife. The nil-rate band allowance at the time of his death is £300,000 so Mr. Smith has used 50% of his allowance. When Mrs. Smith dies in 2010 the nil-rate band allowance is £350,000 and she will benefit from an increased allowance of £525,000 (£350,000 plus 50% of £350,000).

The maximum amount that can be claimed is 100% of the nil-rate band allowance at the time of death. So if someone has remarried several times, they can only claim one extra allowance.

At the time of writing it is understood that the measure will be backdated indefinitely for widows and widowers. It gives those who have already lost their spouse or civil partner, the ability to take advantage of the increased allowance no matter when the first partner died or dies.

When the surviving spouse dies, IHT is paid on everything over the combined allowances (max £600,000 at the time of writing). So for example, on an estate of £800,000 40% of £200,000 is paid to the taxman. That is a sum of £80,000! It is therefore vital that appropriate planning is done whilst both partners are still living.

Unmarried Couples

Unfortunately, for unmarried couples, there is no spouse exemption from IHT on first death so any amount transferred that is over the current NRB will be taxed at 40%.

EXAMPLE: Andrew and Barbara have lived together for 15 years and have three children aged 7, 10 and 12. They own a house together worth £350,000 held as tenants in common* in equal shares. They have other assets worth £40,000, (each partner has £20,000 in their own name). The house is mortgaged but an insurance policy will pay off the mortgage on first death.

If they simply make standard Wills leaving everything to each other (and to the children if their partner pre-deceases), then on current figures no inheritance tax would be payable on first death as each partner's estate is worth less than £300,000. However on second death the survivor's estate would be worth £390,000, which would attract an IHT bill of £36,000!

Of course, one way they could save this tax is to leave their respective estates to the children on first death, however this could leave the survivor financially disadvantaged.

If Andrew and Barbara made Inheritance Tax Saving Wills their children could be saved the tax bill. These wills allow a legacy of up to the current Nil Rate Band to be made to a discretionary trust in favour of the children. The trustees will have powers to loan the trust assets back to the surviving partner who can still have access to the trust fund provided they promise to repay the loan from their estate. The surviving partner's estate would then be worth only £195,000 and remain tax-free when it eventually passes to the children. It is advisable for the Trustees to charge interest on loans made from the Trust Fund.

*For efficient IHT planning, it is important that as far as possible, each partner has the same amount of assets in their estate. The most efficient way to do this is to change the way that you own your home. Properties owned as Tenants in Common in equal shares, enable half the value of the home to be included in the value of each partner's estate.

For further advice on how this affects your own circumstances, contact us and make an appointment.