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Are you Will-ing to plan for IHT?

Inheritance Tax (IHT) is a tax that needs to be taken seriously by any individual with assets in excess of £325,000. Taking some basic steps can mean that your family may be able to avoid the worst ravages of an IHT bill after you die.

Significant steps can be taken in lifetime to pass on assets but it is not always possible to achieve this and so planning a tax efficient Will should be seen as a major part of the tax planning agenda. This briefing focuses on the need to make a Will and how to make it as tax efficient as possible.

Why bother with a Will?

A Will is a very personal document in which the person writing it (known as the 'testator') sets out how their estate should be distributed after their death. Where an individual dies without leaving a Will the rules relating to intestacy come into play. These rules are set out in law and provide a formula by which the estate is to be divided. Different rules apply in the different countries which make up the United Kingdom.

One particular point which runs through all the sets of rules is that under intestacy, provision is made for a spouse and for children. There is no provision for an unmarried partner which could cause significant problems for the surviving partner in such situations.

There may not be major financial matters to deal with in a Will but it is important to express direction about particular assets, to identify care issues for minor children and to express wishes about a funeral.

If you have assets in another country outside the UK you should take advice on writing a Will in that country to deal with those specific assets. Legal problems could arise for your survivors if you do not.

Transfers between spouses

It is quite understandable that when one spouse dies they will want to ensure that their surviving spouse is financially provided for. The IHT rules recognise this and include a very important provision which allows transfers between

spouses (including registered civil partners) to be exempt from IHT.

This exemption has been reinforced by legislation which allows the IHT nil rate band (NRB) to be transferred between spouses as well. Currently, the first £325,000 of any estate is taxable to IHT at 0% and it used to be the case that where assets were transferred between spouses on the first death, the couple were only able to use one NRB against their joint estate. This anomaly has been corrected by what is referred to as the 'transferable nil rate band'.

It works like this. When the first spouse dies they can leave all their estate to their surviving spouse. That will be an exempt transfer. When the survivor dies, their estate can claim the benefit of any NRB not used at the time of the death of the first spouse. The unused percentage is added to the NRB of the survivor.

Example

George died in January 2008. He had total assets of £750,000 which he left to his widow Sheila. That transfer was exempt and so none of George's NRB was used. Sheila dies in 2012 leaving a total estate of £900,000. The IHT bill will be just £100,000 (£900,000 - £650,000) x 40%. Under the old rules the IHT bill would have been £230,000 (£900,000 - £325,000) x 40%.

If George had left £100,000 of his estate to his children it would be necessary to work out what percentage of his NRB was unused. In January 2008 the IHT NRB was £300,000 and so the unused percentage is (£300,000 - 100,000)/300,000 = 66.6%. On Sheila's death the NRB available to her would be increased by that same percentage and would be 66.6% x £325,000 plus her own NRB of £325,000 = £541,450.

The rules apply to any couple irrespective of when the first spouse died. HMRC will want some documentary evidence to back up the claim. This will include copies of the death certificate of the first spouse, the marriage or civil registration certificate of the couple and details of the probate on the first death. It is important to have this information available as HMRC will not process claims without it.

Where a surviving spouse remarries it is possible that their estate in theory could have the benefit of NRBs from two deceased spouses. The legislation does not allow the collection of NRBs! The maximum additional allowance is 100% of the current NRB.

Should we automatically use the transferable NRB?

There is no doubt that the transferable NRB has simplified IHT planning for many married couples and registered civil partners. If the combined estate of the couple is below twice the current NRB and is not likely to grow significantly then the transferable nil rate band is the simplest route to take.

There are however two situations in which an alternative approach may be more desirable.

- The first is where there are assets which may qualify for one of the special reliefs for business or agricultural property.
- The second is where assets in the first estate are likely to grow significantly in value.

Dealing with business assets

Some assets such as shares in a private trading company and agricultural property are eligible important reliefs which can significantly reduce the IHT bill. Business Property Relief (BPR) can be up to 100% of the value of the business

assets concerned and a similar percentage can apply for Agricultural Property Relief (APR). The precise conditions for these reliefs are complex and we can provide advice on your particular situation.

Very importantly, these reliefs are only available in situations which generate a chargeable transfer for IHT purposes and so they will not be used in situations where the qualifying assets pass directly to the surviving spouse or registered civil partner. This means that it is possible that the relief may be lost if the survivor decides to sell the asset concerned. Cash proceeds derived from a qualifying asset are not eligible for the relief.

Consideration should therefore be given to transferring these assets into a discretionary trust on the first death to ensure that the relief is utilised. Any subsequent sale will then be in the trust (this may require some careful planning for capital gains tax (CGT) purposes). The potential savings can be very significant as the following example shows:

Example

Keith holds shares (current value £900,000) in an unquoted trading company. The shares qualify for 100% BPR. Other personal assets for IHT total £500,000. Under Keith's Will all the assets pass to his widow Linda.

The IHT position on Keith's death will be a nil liability and all his NRB remains intact.

After Keith's death, Linda sells the shares for £900,000. She dies with the cash and other assets still in her estate. The NRB at the time of her death is £350,000. The IHT position on her death will be:

	£
Value of estate	1,400,000
Less 2 x NRB	(700,000)
Taxable	700,000
IHT payable	280,000

If Keith had through his Will put the shares into a discretionary trust the situation on his death would have been:

	£
Value of shares	900,000
Less 100% BPR	(900,000)
Taxable	nil
IHT payable	nil

His NRB would not have been used as the balance of his assets passed directly to Linda. On her death the IHT position would be:

	£
Value of estate	500,000
Less 2 x NRB	(700,000)
Taxable	nil
IHT payable	nil

The value of the shares net of CGT would be in the trust and a saving of £280,000 would have been made on the IHT bill.

Dealing with growth assets

The transferable NRB is fine where the assets passing on the first death grow at a rate no greater than the rate of growth in the NRB. A greater tax bill can arise if the growth in the value of the assets outstrips the NRB. This is currently of particular interest as the NRB has been frozen until April 2015 at £325,000.

The alternative is to redirect the asset away from the direct ownership of the surviving spouse on the first death. If the surviving spouse is not going to need the asset (or the income it generates) then a transfer to other family members of an amount up to the NRB on the first death will work. If the surviving spouse does need some access to the asset then the vehicle of a trust would be a better solution.

The trust in this case must be a discretionary trust where all decisions as to the distribution of capital and income are left to the trustees. The surviving spouse can be one of the trustees. A discretionary trust is treated as 'relevant property' for IHT purposes which means that the value of the assets in the trust cannot be added to other assets that a trust beneficiary may own. This means that if the assets in the trust grow significantly between the first death and the death of the surviving spouse all of that growth will not be chargeable to tax when the survivor dies. It should be pointed out that there are IHT charges which can arise within a discretionary trust but these should be significantly less than the equivalent charge if the asset remains in an individual's estate.

Example

Ian has a property in his estate which is currently used only to generate rental income. Its current value is £325,000 but if the local development plan is adopted, the site will be in a key area and could be worth £750,000. Ian's other assets are £500,000. Ian dies in 2012 when the NRB is £325,000.

He leaves all his estate to his widow Joy. The development plans proceed as they hoped and the property is sold for £750,000 (CGT would be due but is ignored for the purpose of this example). Joy dies in early 2016 with the cash from the sale of the property and the other assets inherited from her husband.

Her IHT position will be (NRB assumed to be £350,000 in 2016):

	£
Value of estate	1,250,000
Less 2 x NRB	(700,000)
Taxable	550,000
IHT payable	220,000

If Ian had put the property into a discretionary trust the position on his death would have been:

	£
Value of estate	325,000
Less NRB	(325,000)
Taxable	nil
IHT payable	nil



On Joy's death the IHT position will be:

	£
Value of estate	500,000
Less own NRB (no transferable NRB as all used on Ian's death)	(350,000)
Taxable	150,000
IHT payable	60,000

The proceeds from the sale of the rental property held in the trust are not included in Joy's estate and the IHT saving on her death is £160,000.

Passing on to a surviving spouse

There is a further issue of concern for some families. This is where it is desired that the ultimate recipients of the assets are other family members but at the same time ensuring that the surviving spouse benefits during their lifetime. This can be a particular factor where there are children of the marriage and it is possible that the surviving spouse could remarry. If all the assets are transferred directly to the survivor on the first death, then on the death of the survivor it is possible that some of those assets could pass to beneficiaries other than the children of the first marriage.

This position can be avoided by transferring the assets into another type of trust on the first death which gives an interest in the income of the estate to the surviving spouse for their life. On the death of the second spouse, the trust then passes the capital to specific beneficiaries (i.e. the children). The first transfer is still subject to the spouse exemption and in this situation (unlike the discretionary trust described earlier) the value of the assets in the trust are taxable on the death of the second spouse. In IHT terms there is no tax saving under this route but the fulfilment of a personal wish to direct assets ultimately for the benefit of the children can be achieved.

To sum up

Ensure that you keep your Will updated so that it 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.

IHT planning should always be done on a personal basis because every estate and every family situation is unique. Taking advantage of the planning opportunities can make a huge difference to the value of your estate which eventually passes down to your children. We would be happy to talk with you about how these opportunities might be used in your situation.