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Inheritance Tax and Estate planning through your Will

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Your Will

A Will can help to minimise the impact of taxation on your estate and can also assist in preserving assets for future generations. With regard to Inheritance Tax, it is well-known that ownership of substantial assets may result in an Inheritance Tax (IHT) liability to your estate. IHT is payable on the value of your estate when it exceeds a specified sum which is often referred to as the “Nil Rate Band” (NRB). The government regularly reviews how much the Nil Rate Band should be and the present government has already set an agenda for the next few years, giving details of the expected alterations to the Nil Rate Band for that period of time.

Each individual is entitled to make use of their nil rate band

Nil Rate Band

Until recently, there was a clear need for certain steps to be taken to utilise the Nil Rate Bands of both husband and wife and civil partners where assets passed between them under the terms of their Wills.

Although no tax is payable when a spouse leaves his/her estate to the other, both estates are then combined when IHT is assessed on the second death. Until recently, this presented a clear problem, unless a Discretionary Trust utilised the NRB on the first death (Example 2).

An example of how this affected gifts between spouses is set out below (Example 1)

Example 1

All assets passing to the surviving spouse on first death.

	Mr. Jones	Mrs. Jones
Assets	£350,000	£350,000
Mr Jones' assets pass to Mrs Jones on death		£700,00
Less Nil Rate Band		<u>£325,000</u>
Chargeable Estate		£375,000
Tax Payable at 40%		<u>£150,000</u>



The Inheritance Tax liability can be mitigated in example 1 by leaving some or all of the Nil Rate Band on the first death to a person or persons other than your spouse (eg to your children). The difficulty with this has always been that the surviving spouse could not benefit from the money.

An alternative and more flexible option has been to leave the Nil Rate Band to a discretionary trust (a “Nil Rate Band Discretionary Trust”) of which the spouse can be a potential beneficiary along with children, grandchildren or any other party you wish to name.

The Trustees have the power to release capital and/or income to any of the named beneficiaries during the trust period, and this would allow the surviving spouse to benefit from the fund if he or she needed to.

We have always advised that a separate letter of wishes should be kept with the Will explaining to the Trustees of the Nil Rate Band Discretionary Trust that, despite the fact that there are a number of beneficiaries, it is the surviving spouse who should be given priority and whose standard of living should be preserved so far as is possible.



The beneficial effects of the nil rate band discretionary trust can be seen in example 2.

Nil Rate Band passing to Discretionary Trust on first death

Example 2

Nil Rate Band passing to Discretionary Trust on first death

	Mr. Jones	Mrs. Jones
Assets	£350,000	£350,000
Of Mr Jones' £350,000 Estate, £325,000 (Nil Rate Band) passes to a Discretionary Trust On death, the remaining £25,000 passes to Mrs Jones.		
Taxable Estate on second death		£375,000
<u>Less Nil Rate Band</u>		<u>£325,000</u>
Chargeable Estate		£50,000
Tax Payable at 40%		£20,000
(Tax saving using NRB £130,000)		

The Chancellor announced, in a pre-budget statement in October 2007, that the Inheritance Tax position vis-à-vis gifts between spouses in Wills was to change. It was announced that the Spring 2008 Budget would include proposals to enable any unused portion of a deceased spouse’s Nil Rate Band to be available potentially to be carried forward and utilised by the estate of the second spouse to die.

The legislation proposed for the Finance Bill 2008 which became the Finance Act 2008 allowed a claim for the transfer of any unused Nil Rate Band (NRB) on a person’s death to the estate of his or her surviving spouse or civil partner who died on or after 9th October 2007, irrespective of the date of death of the first spouse to die.

The Finance Act 2008 (“the New Act”) and therefore, the previous proposal, is now in force.

The effect of the new Act is illustrated in Example 3 below.

Example 3

All assets passing to surviving spouse on first death (Post 9th October 2007)

	Mr. Jones	Mrs. Jones
Assets	£350,000	£350,000
Mr Jones' assets pass to Mrs Jones on death		£700,000
Less Nil Rate Band (Mrs Jones)		£325,000
Less unused Nil Rate Band from Mr Jones' Estate (applied on Mrs Jones' death)		£325,000
Chargeable Estate (on Mrs Jones' death)		£50,000
Tax Payable at 40%		£20,000

As can be seen, the initial effect is similar to that which exists under Example 2.

However, even though it may at first sight appear that the Nil Rate Band Discretionary Trust arrangement is now redundant, there are other reasons for creating a trust under a Will. For instance, to preserve assets for the next generations, having the effect of, for example, protecting assets from vulnerable claims by other organisations.

Assets may well increase in value significantly between the death of a first spouse and the death of a second.

The use of the Nil Rate Band Discretionary Trust will allow for the growth in the value of assets to be protected against additional IHT by virtue of being sheltered by the Trust. In certain circumstances, the Nil Rate Band Discretionary Trusts still serves a very useful purpose in terms of overall estate planning.

The incorporation of the Trust in the will, effective on the first death, affords the family flexibility. It provides a flexible structure for estate planning notwithstanding any future changes that may be made by future governments to inheritance tax legislation.



If you would like further information on Inheritance Tax Planning or any of our Private Client services then please contact a member of our Wills, Trust and Probate Team.

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