HATCH BRENNER

# INHERITANCE TAX


**The basic information set out below is not intended to provide all the answers, and should be read in conjunction with the detailed advice provided.**

**WHAT IS INHERITANCE TAX?**

Inheritance Tax (IHT) is a tax which is paid to the Inland Revenue on death where the value of an estate exceeds an individual's tax-free allowance (the nil rate band). This tax-free allowance rose to £325,000 in April 2009, and is changed every year in the budget.

There are two ways to reduce the IHT payable where an estate exceeds £325,000:

- In your lifetime
- In your Will

**LIFETIME TAX PLANNING**

If you gift assets away and die within seven years of making the gift, the value of cash/ assets when gifted will still suffer IHT on your death. This is called the seven-year rule.

The following gifts are not subject to this seven-year rule:-

(a) The annual exemption - currently £3,000. If you did not give away £3,000 last year, then this tax year you can give away a total of £61000. A husband and wife each have their own allowances for this purpose.

(b) Gifts to a charity, certain political parties, and to your spouse or civil partner.

(c) Excess income unspent each year may be given away, no matter what the total, provided the giving is regular. The word 'excess' is important because if you give income away, and then have to resort to capital sources to keep you in the lifestyle to which you are accustomed, the relief does not apply. Any gifts of income you make would then still fall back into your estate under the seven-year rule.

(d) Marriage gifts of £5,000 to a child by each parent and of £2,500 to a grandchild by each grandparent.

(e) Gifts not exceeding £250 to any number of individuals in any tax year. Care is required if it is wished to make use of this relief in addition to the annual exemption (above). The total number of people who may benefit is not limited.

Certain businesses and agricultural holdings attract relief from IHT at a rate of either 100% or 50%.

**WRITING INSURANCE POLICIES INTO TRUST**

(i) If you have an existing life policy which pays out on death, you may be able to arrange with the insurance company to write it in trust.

(ii) The effect of placing a policy into trust, and surviving seven years, is that the value of the policy, when it pays out on death, does not form part of your estate and does not suffer IHT.

(iii) You can take out a policy of insurance which will pay out on death for the specific purpose of using the proceeds to pay any IHT bill.

**INVESTMENTS**

There are certain investment products which may enable you to invest a sum of money, and which result in the capital you have invested being discounted immediately for IHT purposes (Discounted Gift Schemes). Even with these investments, you can draw an income.

**TAX PLANNING WITHIN YOUR WILL**
**Using the Spouse Exemption**
A husband and wife are now able to use any unused nil rate band on the death of the first of them to die by carrying it forward to the second death. A Will leaving everything to the surviving spouse on the first death will therefore mean there is no Inheritance Tax to pay on the first death and that up to £650,000 will currently pass tax free to children or other members of the family on the second death.

If spouses own assets jointly (i.e. as what is called 'joint tenants' as distinct from 'tenants in common'), then, regardless of what the Will may say, those assets automatically pass to the co-owner.

**WHAT IS THE RATE OF INHERITANCE TAX?**
IHT is paid on an individual's estate at a rate of 40% of the figure over and above £325,000. This means that a substantial proportion of an estate can go to the Inland Revenue if appropriate tax planning steps are not taken.

**NIL RATE BAND DISCRETIONARY TRUSTS / 'DEBT SCHEME'**
Prior to the Finance Act 2007 the purpose of such trusts was to enable parties who are married, or partners under a civil partnership, to take advantage of the Inheritance Tax nil rate band (currently £325,000) available on the death of the first to die.

If husband and wife left their respective estates to each other on the first death, and then to their children on the second death, there would be no Inheritance Tax liability on the first death by virtue of the surviving spouse exemption. Nevertheless, the estate of the surviving spouse would be swollen by the assets of the deceased spouse, and only one IHT nil rate band allowance would be available to be set against the combined values of the two estates on the second death. The simplest way of overcoming this difficulty, and making use of a further nil rate band allowance on the first death, would be to leave assets up to the value of the nil rate band from time-to-time, direct to the children (or to other members of the family) on the first death. This did, however, present the difficulty that those assets ceased to be available for the use of the surviving spouse, who might well need these funds to live on.

The use of a nil rate band (or 'mini') discretionary trust enables assets up to the nil rate band allowance to be left into such a trust on the first death. The surviving spouse will be one of a 'pool' of beneficiaries capable of benefiting from this discretionary trust. Those assets will therefore be available for the use of the surviving spouse at the discretion of the trustees – but do not then form part of the estate of the surviving spouse on his/her death. Although the surviving spouse only enjoys the income/capital of the discretionary trust fund at the discretion of the trustees, and that discretion cannot be fettered, in practice the trustees will be carefully chosen and will exercise their discretion against the background of a 'Letter of Wishes' giving guidance as to how the deceased spouse envisages them using that discretion. The surviving spouse will commonly be mentioned in the Letter of Wishes as the principal person in whose favour the Trustees' discretion is expected to be exercised.

The 'debt scheme' represents a further gloss on the discretionary trust arrangement by allowing the executors/trustees to accept an IOU or mortgage from the surviving spouse, with or without interest. In practical terms, and if this arrangement is implemented, the discretionary trust has no assets on which to bite other than the IOU, and the surviving spouse effectively has unfettered use of the assets of the first spouse to die. The surviving spouse's estate is then reduced by the value of the debt – as well as the spouse's own nil rate band - when he or she dies.

Following the Finance Act 2007, the use of such 'mini discretionary trusts' may become less common although they may continue to offer significant benefits in 'ring fencing' the assets in the trust against claims e.g. for retirement home fees or if the surviving spouse remarries and then divorces or goes bankrupt.

**Alan Dobbins**
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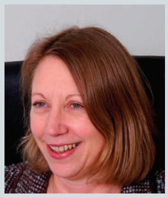

**Dawn Parkes**
Partner at Hatch Brenner since 1991, and head of the probate department. Handles all aspects of wills, probate, trusts and tax planning. Previously specialised for many years in matrimonial matters. Dawn was educated at King Edward VI Grammar School, in Lincolnshire, and studied Law at the University of East Anglia. She holds the Society for Trust and Estate Practitioners' certificate. Leisure interests include reading, badminton, food, and holiday travel.
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**Caroline Billings**
Joined Hatch Brenner's private client department in 2009, and specialises in wills, probate, trusts, tax - planning, enduring and lasting powers of attorney, and Court of Protection matters. She studied at the College of Law, York, and subsequently qualified as a solicitor in 2004 after completing her training contract in Bury St Edmunds and Ipswich. Caroline is a member of the Society of Trust and Estate Practitioners (STEP). She arrived at Hatch Brenner from a Suffolk-based firm, and has spent all of her working life in East Anglia. Caroline is a qualified glider pilot, and in addition to flying she enjoys many other sports including squash, netball and snowboarding.

We will be glad to help at every stage of the process. Please feel free to contact either Alan Dobbins, Dawn Parkes or Caroline Billings for a free initial discussion over the telephone, entirely without obligation. They will be delighted to hear from you.

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