

Inheritance Tax (IHT) and Nil-Rate Trusts

1. Under the current regime, Inheritance Tax (IHT) is not chargeable on transfers between husband and wife or between civil partners (the spouse exemption).
2. In addition, gifts up to the nil rate band (£325,000 from April 2009) can be made by Will free of IHT to other individuals.
3. Gifts in excess of the nil rate band to someone other than a spouse (or civil partner), a charity or a political party attract tax at 40%.
4. Gifts in excess of the nil rate band made during an individual's lifetime may be tax free if survived by seven years. If you die within seven years of making a potentially taxable gift the following rates of tax will be applied:
 - (a) 1 to 2 years = full 40% tax charge
 - (b) 3 to 4 years = 80% of the full tax charge i.e. 32%
 - (c) 4 to 5 years = 60% of the full tax charge i.e. 24%
 - (d) 5 to 6 years = 40% of the full tax charge i.e. 16%
 - (e) 6 to 7 years = 20% of the full tax charge i.e. 8%If you make a gift and survive seven years, that asset is deemed outside of your estate for IHT purposes and therefore not taxable.
5. It follows from the above that a married couple (or a couple in a civil partnership), in theory, can leave twice the nil rate band (£650,000 as at April 2009) IHT free to their children or other relatives on death.
6. To achieve this level of tax-free giving it is necessary to utilise the nil-rate band of the first spouse (or partner) to die. Conventional Wills, where each spouse or partner leaves his or her entire estate to the survivor, effectively increase the final IHT bill by £130,000. (£325,000 x 40%).
7. Very few couples can afford to make an absolute gift of £325,000 to their children on the first death for a number of reasons:
 - (a) Any capital is needed to provide an income for the surviving spouse or partner.
 - (b) The joint estate is taxable in the main because of the value attributable to the family home.

In such cases, it is possible to minimise IHT and provide for the financial security of the surviving spouse or partner, by creating what is known as a Discretionary Trust of the nil-rate band. (Also known as a 'Promissory Trust' or 'Loan Plan' Will)

8. A Discretionary Trust of the nil-rate band provides that the maximum tax-free amount possible is held by the Trustees for the benefit of the surviving spouse (or partner), children and remoter issue (i.e., grandchildren/great-grandchildren, etc).
 - a) The Trustees have absolute discretion as to which one (or more) of the beneficiaries they pay income and/or capital to.
 - b) During the lifetime of the surviving spouse or partner the intention would normally be for the surviving spouse (or partner) to benefit exclusively.

- c) The appointment of trustees needs to be considered carefully, as they will collectively make decisions as to whom, when and how much is paid from the discretionary fund to the beneficiaries. The surviving spouse (or partner) could be a Trustee and therefore involved in this decision-making process.
 - d) The value of the Trust Fund would not form part of the estate of the second spouse (or partner) for IHT purposes. Provided the Trust's value is below the IHT nil-rate band, it would not be subject to IHT on the death of the second spouse (or partner).
 - e) The Trust can include a share of any property owned by the first spouse (or partner) to die (subject to note 8 below).
 - f) Your Trustees have very flexible powers to deal with the assets in the Trust. For instance, they could transfer assets to the survivor of you and take security in the form of a charge or a loan note (IOU). This "IOU" would then be repaid on the death of the survivor, thus reducing the size of the estate of the survivor. This power is particularly useful where property is involved and the survivor would prefer to have the property in their sole name. When the "IOU" facility is utilised, no assets are actually held in the Trust Fund and paragraph 7(a) above becomes irrelevant.**
9. Assets that are held by a couple jointly will usually pass automatically to the surviving joint owner and not through the Will of the first to die. Thus, if a couple wish to take tax-planning steps through their Wills, it is necessary to ensure that each partner has at least the nil rate band in his or her sole name, or that any joint property is held by the partners as "tenants in common". Assets held as "tenants in common" will still be in the joint names of the owners, but the share of the deceased will not pass automatically to the surviving joint owner. Instead, it will devolve in accordance with the provisions of any Will, and therefore may be used to avoid IHT via the Trust Fund.
10. It is important to note that usually gifts made within seven years of death in excess of £3,000 to someone other than a spouse or charity will be taken into account in determining the value of an individual estate for IHT purposes. In effect, such gifts reduce the amount of tax free giving that can be made on death. This does not apply to gifts between husband and wife (or between civil partners) whenever made; again, the *spouse (or civil partner) exemption* rule applies.
11. Where a property is owned as Tenants in Common, or when a Will creates any form of trust, Probate will almost certainly be required to either deal with the share of the property of the deceased or to set up the trust under the terms of the Will. This will involve legal and administrative fees if professional services are utilised at that time.
- 12. Where one or both partners have been widowed, it is possible to claim unused transferable allowance and take advantage of up to three nil-rate allowances. Using the appropriate Estate Planning structure, Inheritance Tax savings of up to £260,000 are achievable.**

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