

PRE BUDGET REPORT 2007 IMPORTANT CHANGES TO INHERITANCE TAX FOR MARRIED COUPLES*

The Changes

The Chancellor has announced the following changes to the Inheritance Tax (“IHT”) rules, which apply with effect from 9th October 2007 to the Nil Rate Band (the “NRB”) – that is the amount each person is allowed to leave without IHT arising on death (currently £300,000) - as it affects married couples. The changes are **not** applicable to single people, unmarried couples, or other family relationships:

- The married couple will be entitled to use two NRBs so that, to the extent that the NRB available on the death of the first spouse is unused, the unused proportion will be added to the NRB available on second death. For example if both spouses unfortunately die in this tax year, they will have a total NRB of £600,000 between them before any tax is payable on the second death
- Where the first death has already occurred, on **any** date prior to 9 October 2007, however long ago, the unused proportion of the NRB on that death can be added to the NRB on the second death. For example: on death 1, in tax year 2007, if only half of the available NRB (£150,000) is used, then on death 2 in, say, 2010 (when the NRB will be £350,000), the second NRB will be increased by £175,000 (ie 50%) to £525,000. This results in a tax-free gift of £675,000 to their heirs.

As can be expected, the new rules are likely to contain various “wrinkles” in the way they are actually operated and it will be essential for each married couple to consider carefully their own particular circumstances. However, one point is clear: there is no actual increase in the amount of the NRB for anyone. It is just that married couples will be able to take the benefit of up to two NRBs on the second death without having to enter into complex tax saving arrangements through their Wills. This is a highly sensible development but one which will affect different couples in different ways.

The following scenarios may help you to understand how the new rules affect you:-

Both spouses are still alive and their combined assets exceed twice the current NRB (ie. they have more than £600,000)

If you already have “tax efficient” Wills (including “NRB discretionary trust” arrangements, or an outright gift of the NRB to, say, your children), then there is no need at all to change your Wills, unless you have any non-tax related reason to do so.

If you don’t have “tax efficient” Wills, then it is possible for you to use 2 NRBs via straightforward Wills leaving everything on the first death to the surviving spouse. But there may still be very good reasons (primarily, flexibility) for including an NRB discretionary trust arrangement in your Wills. You will certainly wish to consider lifetime tax planning opportunities.

Both spouses are still alive and their combined assets DO NOT exceed twice the current NRB (ie. they have less than £600,000)

The same principles apply: if you have tax efficient Wills, stick with them. If you don’t, then you probably won’t need them, and straightforward Wills should work well for you. Lifetime tax planning is likely to be less of a concern for you.

One spouse has already died and there are no tax saving arrangements in place

The survivor will be able to add to his/her own NRB the proportion of the NRB unused on the first death (see the example above).

Note that the probate procedures on the second death are likely to become more complicated, as the circumstances in relation to the first death (possibly not recorded, or even investigated, at the time) will need to be closely examined to verify the unused proportion of the first NRB in order to enable it to be claimed on second death.

One spouse has already died (LESS than two years ago) and there are tax saving arrangements in place (eg an NRB discretionary trust)

It may be preferable to abandon the complications of the trust by passing the trust assets to the surviving spouse. This will simplify matters going forward and still allow the double NRB to be used on the second death.

If one spouse has already died (MORE than two years ago) and there are tax saving arrangements in place (eg an NRB discretionary trust)

There is likely to be a tax **disadvantage** in breaking the trust since the NRB on the first death will be treated by the Revenue as having been used in whole or part (depending on values). To break the trust in favour of the survivor will add to his/her assets and he/she may have available only their single NRB.

Deeds of Variation

There will no longer be a tax advantage in executing a deed of variation to use up the NRB of the first spouse to die, since any unused proportion will automatically be available to add to the NRB on the second death. There may however be other reasons for going down this route.

HEALTH WARNING

As ever, the statements in this note are generalisations and may not precisely fit your individual circumstances. Please contact any of the following in the Taylor Walton Private Client team to see what the new rules mean in your individual case:

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* Statements in this note relating to married couples apply equally to registered civil partners