



### Background

1. Inheritance tax is payable on estates that exceed a threshold from time to time. The current threshold for individuals is £300,000 and the rate of IHT on assets over the threshold is 40%.

2. There are exemptions and reliefs to IHT and the main ones are:

- There is no IHT on assets which pass outright (or in certain cases by trust) between husband or wife, or between Civil Partners ("the spouse exemption");
- From 06/04/2007 there is no IHT on the first £300,000 of a person's estate ("the nil rate band");
- Assets which have been used in a business or for agricultural purposes may qualify for up to 100% exemption for inheritance tax purposes because they attract Business Property Relief or Agricultural Property Relief.

3. For the purposes of this note please bear in mind that Civil Partners have the same rights as spouses and references to spouses, a spouse, husband or wife are references to Civil Partners or a Civil Partner as the context admits. For the purposes of the examples below we have presumed that a husband predeceases his wife and the threshold and the rate of tax are those that currently apply.

4. Prior to 9 October 2007 a problem arose with the interaction between the spouse exemption and the nil rate band. If, on the first death, a husband left everything to his wife there would be no inheritance tax payable because of the spouse exemption. However, all of the assets of the marriage would then vest in the wife and on her death she would have her nil rate of £300,000 available to her.

5. The problem with the preceding paragraph is that two people have died and only one nil rate band is being used. The aim for tax planning purposes was to ensure that where two people died the nil rate band was being utilised for both of them, i.e. £600,000. This was achieved by making use of the nil rate band on the first death, most commonly by placing it into a discretionary trust that could be available to the wife if needed, but otherwise was outside her estate. This has been standard inheritance tax planning in Wills for some time.

### The changes

1. In his pre budget report on 9 October 2007, the Chancellor has introduced a change to the way in which the nil rate band is applied to married couples. He has introduced a "transferable nil rate band" between spouses. It will now be possible for the surviving spouse to "double-up" on the nil rate band on gifts made by them under their Will.

2. The threshold itself has not been increased, in that individuals continue to have a threshold of £300,000. The rate of tax has not been changed and this continues to be 40%. The change relates only to married couples in that, instead of each of them having their own £300,000 they now have a combined £600,000.

3. Accordingly, if, on the death of the husband, everything passes to the wife, then on the husband's death his unused nil rate band is transferred to his wife so that on her death she has the full £600,000. There is no longer any need to do this by means of a nil rate band discretionary trust, which in effect, was a way in which spouses ensured that their nil rate bands transferred to the surviving spouse.

4. Unless there are business or agricultural assets, the use of a nil rate band discretionary trust is now unnecessary for inheritance tax planning purposes. In future, spouses can leave everything to each other without having to worry about incorporating the previous "standard" inheritance tax planning of a discretionary trust.

### Existing Wills

1. Wills that have already been prepared incorporating discretionary trusts of the nil rate band are not detrimental. All that will happen is on the death of the first spouse the trustees will effectively wind up the trust in favour of the surviving spouse by a simple deed of appointment. If this is done within two years of the date of death then it is read back as having effect under the Will, and the benefit of the new arrangements will be gained.

2. As part of the implementation of the scheme, it was common to sever the joint ownership of your property so that spouses held their property as beneficial tenants in common in equal shares. The title to the property still remains in the joint names of both spouses and they can sell, lease, mortgage the property etc. as they see fit.

3. The only issue will be that there is a little bit extra to do in the administration of the estate. As far as the trust is concerned then this will need to be wound up. As far as the house is concerned then this will need to be transferred to the surviving spouse and will require a Land Registry transfer rather than automatically passing by survivorship. It will also incur a Land Registry fee in respect of the transfer, commonly £40 but it could be higher depending on the value of the property.

## What to do next

1. For those clients where we were in the process of preparing Wills, or where we have had discussions in the past concerning the preparation of Wills, these need to be independently reviewed with us and we will be writing to you separately in connection with that.

2. For those who have already made Wills then, as stated above, there is no detriment to you other than having to wind up the trust on the first death, which is a simple procedure. If you wished to make the Wills simple then straightforward Wills should be prepared, leaving everything to each other and then to the residuary beneficiaries that you choose.

3. Please note that the use of discretionary trusts may still be appropriate if you own business assets or agricultural property because of the availability of business property relief or agricultural property relief referred to above. However, existing Wills will still need to be reviewed as they will undoubtedly also incorporate a trust of the nil rate band. Nil rate band trusts may still be appropriate for appreciating assets, but is impossible to advise on a best course of action because the variables are so wide (eg the amount of any growth, the life expectancy of the surviving spouse, changes in the threshold, changes in the rate of inheritance tax (on death and for the trust) etc.).

4. A knock-on advantage of the nil rate band discretionary trust was that it was also disregarded for the purpose of means tested benefits when assessing a person's liability to pay for their long-time care. In certain circumstances, it may still be appropriate to retain a trust in your Will with a view to long-term care planning which, in itself, can be as big a threat to your estate as inheritance tax. It is unlikely that a nil rate band discretionary trust will be the most appropriate way of achieving this. Wills should also be reviewed in those circumstances.

5. You may consider it desirable to change your beneficial ownership of your home from tenants in common back to joint tenants. This will mean that on the first death the property automatically passes to the survivor of you, and

there is nothing further that you need to do other than send a copy of the death certificate to the Land Registry. If you hold as tenants in common, then the executors of the estate of the first spouse will need to transfer their share of the property to the surviving spouse, i.e. it will not happen automatically. This will need a grant of probate to be obtained.

This will probably be needed in any event in relation to the administration of the estate. There could however be estates where it would not be needed and therefore it would be extra time and expenses. It would also involve a Land Registry fee as it is a transfer of land. To "undo" a severance of joint tenancy a declaration signed by you and, where applicable, the removal of any entry at the Land Registry would be needed.

## Contact Us

Please note that this guide is only for reference only. For more detailed legal advice, please contact our dedicated team direct.



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