

## Pre-Budget Report 2007: Inheritance Tax (IHT)

The Pre-Budget Report announced on 9 October 2007 introduced proposed reforms to the UK Inheritance Tax system. The reforms will ensure all married couples and civil partners have the benefit of their individual nil rate band as well as the 100% spouse exemption without having to undertake specialist will drafting. There have been no proposed changes to the restrictions applicable for gift between UK domiciled and non-domiciled spouses.

In the past, transfers between spouses or civil partners were generally exempt from IHT. However, if the entire estate passed to the spouse under the spouse exemption the couple have effectively waived their eligibility to one nil rate band. In money terms this amounts to £120,000 on today's figures (40% of £300,000).

The new rules apply where the surviving spouse dies after 9 October 2007. The rules allow the widow or widower or surviving civil partner to use any nil rate band that their spouse or civil partner did not use at the time of their death against their own estate.

The amount of nil rate band which is transferable is based on the proportion of the nil rate band that was unused on the first death. In this way any increase in the nil rate band is accounted for. If on the first death none of the nil rate band was taken up by gifts then the available nil rate band on the second death will be 100% more than the nil rate band at the time of the second death, e.g. a husband dies on 5 July 2006 having made gifts of £142,000. He had used 50% of his available nil rate band which was £285,000 for tax year 2006/7. His wife died on 7 July 2007 when the nil rate band had increased to £300,000. She therefore has a nil rate band of £300,000 plus 50% of £300,000 (i.e. 450,000).

The changes make it essential to keep track of any gifts made during the seven year period prior to death. It is essential to keep constant records of gifts which will become part of an estate, remembering that certain gifts can be made without incurring a charge to inheritance tax.

### How will this affect me?

#### Example 1

I visited my lawyer last year and was advised to draft a Will with a trust in it. Is this trust still effective?

#### Answer

It would depend entirely upon what that trust was. If it were a nil rate band discretionary will trust with debt provision then it will have been included by your solicitor or accountant to ensure that you had the full benefit of your available nil rate bands. If you and your spouse are still alive then the trust will most likely not have been created yet. There will be costs associated with its implementation so it may be cheaper in the long run to re-draft your will to remove the trust. This will enable your spouse to have full control of your estate.

If you have a trust in your will it is advisable to seek professional opinion as to whether it is required.

### **Example 2**

My husband died before 9 October 2007. What is the effect of the change in the rules on me?

### **Answer**

The Government has back dated the tax legislation so regardless of how long ago your spouse died then you should be able to utilise the full "couples allowance". You should seek professional advice to establish this extent of the allowance available to you. This will be determined by the gifts made by your spouse during his or her lifetime.

### **Example 3**

My husband died and there is an operative nil rate band discretionary will trust. The running of the trust is incurring significant costs. Is there any way I can reduce these?

### **Answer**

The current advice is that even if you obtain the consent of all the beneficiaries the terms are unlikely to be altered.

### **Example 4**

I have submitted my mother's Inheritance Tax Return. We paid more tax than I believe was due following these changes.

### **Answer**

These changes take effect from 9 October 2007. Where the second death occurred before that date then they do not have an effect.

### **Example 5**

These changes are said to be relating to the couples allowance. I have lived with my partner for 15 years although we are not married. Will they be effective for us?

### **Answer**

No. This change is for married couples and civil partners only. Co-habitees do not benefit.

***This article is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from action on the basis of the contents of this article.***

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