

TAMING INHERITANCE TAX

This leaflet gives general guidance only. It should not be relied on for major decisions on property or tax. You should consult a qualified accountant, tax adviser or lawyer before taking action on the basis of the information in this leaflet.

No-one enjoys paying any tax. But Inheritance Tax, or IHT, seems to be hated more than most. People have worked hard for their money, their home or their property and they believe they should be free to pass these possessions on to their heirs. The next generation often feels that the property of their parents – particularly the ‘family’ home – is somehow theirs and that taxing it is tantamount to theft, especially if they fear that the home will have to be sold to pay the tax.

Despite these concerns, only a small minority of estates are actually liable to Inheritance Tax. In 2006 more than 572,000 people died in the UK but in 2006/07 only 33,000 estates had to pay IHT. That is less than 6% of those who died so for every 100 people who died in 2006 IHT was not an issue for 94 of them – though some of those were exempt only because they were a spouse or civil partner and inherited the whole estate free of IHT.

The anxiety about IHT is due to the rapid rise in house prices. For most people their most valuable possession is their home and the value of the average home has risen far more rapidly than the increase in the threshold at which IHT begins. If the IHT

threshold had gone up in line with house prices since 1996 it would now be £575,000 instead of its 2007/08 level of £300,000. That current threshold feels uncomfortably close to the average price of a home in the UK which is now around £200,000. In parts of the country most homes are sold for more than £300,000. So many people fear that their estate will be liable to IHT when they die. Of course, IHT is due on the whole value of what you leave not just your home but for most people it is that which drags their estate into the IHT net. Rising house prices are behind the rise in the number of estates liable to the tax which has almost doubled from around 18,000 each year in the nineties to the current level of 33,000.

The strength of feeling about Inheritance Tax was shown in September 2007 when the Conservative shadow chancellor George Osborne promised his Party conference that the next Conservative government would raise the threshold before IHT applied to £1 million. That simple promise was widely credited with giving the Conservatives a clear lead over Labour in the opinion polls and derailing the Government's plans for an autumn election.

In response the Chancellor Alistair Darling introduced a complex but expensive change in the rules which would remove the fear of IHT from most families headed by a married couple or civil partners. For their heirs the threshold at which the tax begins has effectively been doubled. The result will be to relieve thousands more estates from the tax and reduce the amount the tax brings in by more than £1 billion a year. The Chancellor also promised that "in future years we will take both house prices and inflation into account when setting inheritance tax thresholds." It is not

clear whether that will apply to the thresholds for the next three years which have already been announced or whether they will remain as they are.

Men, women, and couples

There are now no differences in the way tax law treats men and women and it treats married couples and same sex civil partners identically. So in this leaflet the word 'marriage' includes same sex civil partnerships and the phrase 'married couple' includes a same sex couple who are civil partners and the word 'spouse' includes civil partner. Also 'widow' includes widowers and bereaved civil partners. And when I write 'she' I could just as well write 'he' and vice versa.

Will my estate pay IHT?

To see if your estate will be liable to Inheritance Tax when you die, add up the value of everything you own, including your house, any investments, savings, personal property, and the value of any life insurance policies which form part of your estate (see 'life insurance' below on how to avoid IHT on these). Then add on any gifts you have made in the past seven years (except gifts that are exempt – see 'reducing the tax' below). Take away from this total any debts. They include a mortgage or equity release debt, any other loan secured on your home, any money you owe on credit cards, any personal loans or hire purchase agreements, and any unpaid bills, including any income tax you may owe. You can also deduct the reasonable costs of your funeral. Take away from this total anything you intend to leave to charity. Then consider your marital status.

- **SINGLE – anyone who is not married at the time they die. That includes divorced people and civil partners whose relationship has been ended by the courts.**

If the final amount is £300,000 or less then no tax will be due. If your total is more than that, it is likely that there will be IHT to pay.

- **COUPLES – who are married or civil partners now and will be when the first dies.**

If the final amount is £600,000 or less then no tax will normally be due when the second member of the couple dies. If your total is more than that, it is likely that there will be IHT to pay by your heirs when the second dies. That assumes that the first to die leaves everything to their spouse **which is now the recommended advice**. Anything left to a spouse is completely free of IHT.

- **WIDOWED – someone whose spouse or civil partner is already dead.**

The tax-free amount depends on what the first to die left on their death. If everything was left to the spouse then no tax will normally be due on the first £600,000 when the widow dies. If the late spouse left money or property to someone apart from the surviving spouse then the widow will be able to leave at least £300,000 and up to £600,000 to her heirs with no tax due.

The rules affecting couples and widows are explained in more detail later.

The threshold normally changes on 6 April each year (though that was not always so in the past) so The thresholds of £300,000 or £600,000 apply for this tax year – 2007/08. Strictly speaking the ‘threshold’ is called the ‘nil rate band’ because on that band of estate value the rate of tax is nil. The thresholds for the next few years have already been announced – see Table 1 – though they may be changed for political reasons in future.

Table 1 Thresholds for Inheritance Tax 2007/08 to 20010/11		
	Single	Married couple when the second spouse dies
2007/08	£300,000	Up to £600,000
2008/09	£312,000	Up to £624,000
2009/10	£325,000	Up to £650,000
2010/11	£350,000	Up to £700,000
Thresholds from April 2008 have been announced but may be changed.		

The rate of IHT is 40% of the excess above the threshold. To work out the tax due subtract the threshold from the value of the estate and multiply the answer by 0.4. So this year the Inheritance Tax on an estate of £400,000 left by a single person will be $£400,000 - £300,000 = £100,000$; $£100,000 \times 0.4 = £40,000$. And the Inheritance Tax due on an estate of £750,000 left by a widow who inherited all of her late husband’s estate will be $£750,000 - £600,000 = £150,000$; $£150,000 \times 0.4 = £60,000$. Table 2 gives some examples of the tax due on estates of various sizes for single people and on the second death in a couple where the widow inherited all her late spouse’s possessions.

Estate value	Single*	% of total	Couple, second death	% of total
£300,000	£0	0%	£0	0%
£350,000	£20,000	6%	£0	0%
£400,000	£40,000	10%	£0	0%
£500,000	£80,000	16%	£0	0%
£600,000	£120,000	20%	£0	0%
£750,000	£180,000	24%	£60,000	8%
£1,000,000	£280,000	28%	£160,000	16%
£1,500,000	£480,000	32%	£360,000	24%
£2,000,000	£680,000	34%	£560,000	28%
£3,000,000	£1,080,000	36%	£960,000	32%

*also includes first to die in a couple who leaves items to someone other than their spouse

Reducing the tax

There are several ways to reduce the amount of IHT which is due. Anything you give away more than seven years before your death is completely exempt from Inheritance Tax. So if you are healthy and you have substantial assets and you start giving them away in, say, your fifties or sixties then as long as you live seven years from the date of the gift no IHT will be due on that money. Technically these are called Potentially Exempt Transfers or PETs as they are only exempt if you live another seven years.

But, and there is a big but here, if you give something away and continue to use it then it is still counted as part of your estate. For example you might give your daughter a valuable painting but she lets you continue to hang it on your wall. A present like that is called a 'gift with reservation of benefit' or GROB. And it counts as yours not hers when your estate is taxed.

This rule applies equally to your home. So if you give your home to your children but you continue to live in it then it is counted as your property, not theirs, when you die. In theory it is possible for you to live in the home without any benefit if you pay your children a market rent for it. But they would then have to pay income tax on the profit from the rent and they would also have to pay capital gains tax on the rise in value of the home from when you make the gift to the time you die. So it is usually not a good idea.

There is one exception to this rule. If you give your home away to a relative, move out, but then have to move back either due to unforeseen circumstances or because you are unable to maintain yourself due to old age or infirmity, then its value may not form part of your estate. This rule is complicated and the Revenue will look carefully at any claims that make use of it.

There is another problem with giving things away. If you give away an object or an investment which is now much more valuable than when you acquired it – perhaps some shares you bought in the 1960s – then you may have to pay Capital Gains Tax on the growth in its value. When you give it away, the tax is calculated as if you had sold it at market price on that date. So it is much simpler to give away cash.

Each year you can give a certain amount away and it will be exempt from Inheritance Tax even if you give them away and die shortly afterwards. You are allowed to give away up to £3,000 each tax year without it counting towards the IHT arithmetic at all. And if you gave nothing away in the previous tax year then you can bring £3000

forward from that year and give away £6000 this year without running the risk of IHT being due on it even if you die tomorrow.

If there is a wedding in the year then you can give up to £5,000 to a child of yours as a wedding gift – and up to £2,500 to a grandchild (or great-grandchild) or £1,000 to anyone else on their marriage. The gift has to be conditional on the wedding taking place.

You can combine these two exemptions. So you can give £5000 to one of your children on their marriage **and** give them up to £3000 as well. Apart from these two big exemptions you can give away any number of small gifts up to £250 each to any number of separate people. However, these recipients cannot also get money from you under any other exemption.

You can also give away some income free of tax. If you have a high income and can afford to give away part of it without reducing your own lifestyle, then that part is completely exempt. For example an elderly widow who inherited a good pension from her late husband might now feel her income considerably exceeds her needs. The balance could be given to younger members of the family rather than accumulating in her bank and being liable for tax when she eventually dies.

You can also give money for the maintenance of someone without it counting as part of your estate. There are three separate exemptions set out in Inheritance Tax Act 1984 s.11.

- Gifts to your ex-spouse (or ex-civil partner) a gift for their maintenance are exempt.
- Gifts to your children (but not grandchildren) are exempt while they are in full time education if the money is given for their maintenance or the costs of their education or training. So if a parent pays off a child's student loan or pays their tuition fees then that payment should be exempt from IHT. Take care to pay it by 5 April after their full time education comes to an end or it may not be exempt.
- Gifts for the maintenance of any relative who is financially dependent on you are exempt.

Anything left in your will to a registered charity, to a university, to a national museum or art gallery, or to one of the eight political parties which have at least two MPs in the UK Parliament is completely exempt from Inheritance Tax. Gifts to such bodies may be laudable aims. However, giving money to charity should be done for its own sake not as a way to avoid tax. Your heirs will be better off having 60 per cent of something than 100 per cent of nothing.

John has an estate worth £400,000. He decides to give £100,000 to a charity which rescues donkeys. That brings his estate down to £300,000 so no Inheritance Tax is due and his three children get £100,000 each. Had he not made the gift, the estate would have been £400,000 and after paying £40,000 tax the children would have had £120,000, an extra £20,000, each.

All these allowances are personal. So two parents can each give £3,000 a year and if they gave away nothing last year, they can give £12,000 this year between them without it counting as part of their estate. If they are married or civil partners it doesn't even matter if only one of them has the money – one can give the money to the other with no tax consequences who can then make the exempt gift.

All these amounts are completely exempt from IHT however short a time you live after making them. Remember that if you live for seven years after making **any** gift then that is also completely exempt.

A spouse who has inherited everything for their late wife or husband is not completely free to give that property away. If the person who has died left any instructions to her to make gifts out of the property and she makes them within two years of the death then those can be counted as if they had been made out of the estate. That would reduce the allowance available to be passed on when the widow eventually dies. If you want your widow to pass things on after your death it is safest to convey that information verbally and not to make it binding. Otherwise the gifts should not be made for at least two years after the first death.

One final point on gifts. Never give away money that you need. It is your money, not your heirs'. You worked hard for it and you should benefit from it during your own life.

Records

There is no obligation to keep records of gifts – exempt or not – that you make while you are alive. However, there is an obligation on your executors to discover them all and to make sure the correct Inheritance Tax is paid. So it is very helpful to your executors – who will normally be your heirs – to keep a note of gifts that you make. If you think they are exempt gifts then explain why. Keep these documents with your will or other papers so that it is easily found.

Equity release

Some advisers will suggest you take out what is called an ‘equity release’ plan to reduce your liability to Inheritance Tax. It works like this. You borrow money against the value of your home. While you are alive you pay no interest on the loan. When you die the loan and all the accrued interest is paid off from the value of your home which is therefore less and the Inheritance Tax is reduced.

Equity release might be a perfectly sensible way of raising money if you need more income or capital in retirement. And of course taking out an equity release product will reduce the amount of your estate and the tax due. But that is a side effect. You should never embark on equity release just to reduce IHT. If you do not need extra capital or income then equity release should never be considered. As with giving to charity it is better for your heirs to have 60 per cent of something than 100 per cent of nothing.

Life Insurance

If you have a life insurance policy that pays out on your death the money will normally form part of your estate. The same is true of a death-in-service benefit or

insurance paid as part of a pension or part of some sorts of mortgage. However you can usually avoid IHT being due by making the policy what is called 'written in trust'. Instead of going directly to your dependants the money is paid into a trust which then passes it on to your dependants. That two-step process avoids the proceeds counting as part of your estate. However, this arrangement is now more difficult following recent changes in trust law.

In the past the proceeds would be paid into what is called a 'discretionary trust' where the trustees decide who to pay the money to and when. They will be professionals with the insurance company and will follow your request set out in what is called a 'letter of wishes'. If such a discretionary trust was written before 22 March 2006 then the arrangement works and no tax is due. But if it was written to a discretionary trust after that date and the value of the policy is more than £300,000 then a tax charge of 20% of the excess will be made when the policy is made over to the trust. If the trustees do not pass over the money to the heirs at once then every ten years another charge of around 6% on the excess over the nil rate band will be due.

An alternative is to write it into what is called a 'bare trust'. With a bare trust the trustees make no decisions – the policy belongs to the people named in the trust who would normally be your heirs. Bare trusts are not subject to any special tax regime – the money is taxed as it arises as belonging to the recipient. There would normally not be any tax due on the premiums you pay or the pay out on your death.

Ask your insurance company if your policy has been written in trust; if it has not, ask how you can do so and make sure it is a bare trust not a discretionary trust if the value

is likely to be more than £300,000. Some insurance companies may make a charge or be less than helpful.

If you have considerable assets and want to give money away in the hopes you will live seven years, you can take out a specific life insurance policy to pay the IHT on it if you do not. The policy should be a pure life insurance policy with no investment element and, of course, the proceeds should be written into a bare trust. Such policies can be very cheap for people in their fifties but of course the older you get the more expensive they become. If you are one of a married couple or civil partnership it is better if the younger partner makes the gift and takes out the life insurance policy.

Married Couples

Husbands and wives (and registered civil partners) do not have to pay any Inheritance Tax on money or property left to them by their spouse. And the new rules for couples mean it is usually best for them to leave everything to each other.

Everyone can leave up to £300,000 free of IHT. In addition a spouse can leave all their goods and possessions tax-free to their spouse. In the past if they did that they wasted their own tax-free allowance as their spouse just had the same £300,000 allowance when they died. But from 9 October 2007 that is no longer true. A widow has a threshold consisting of her own £300,000 allowance **plus** any unused part of the allowance of her late spouse. So if the late spouse left nothing to anyone else the widow has a double allowance when she dies.

The new rules began on 9 October 2007 and apply to

- All married couples in the future
- All widows alive on that date who were widowed before that date

They do not apply to couples where both had died before 9 October 2007.

If the first to die leaves everything to their spouse then the rule is easy. When the widow dies her estate gets a double allowance at the rate current at her death. So if a widow dies in 2007/08 and she inherited everything from her spouse then her estate gets an allowance of $2 \times \text{£}300,000 = \text{£}600,000$.

If the first to die does not leave everything to their spouse then the arithmetic is more complex. If he used half his allowance then half is left and his widow's estate gets half the allowance current at **her** death. So this year she would get her own allowance of $\text{£}300,000$ plus another $\text{£}300,000/2 = \text{£}150,000$ making a total of $\text{£}450,000$.

Whatever proportion of her last husband's allowance was unused she gets that proportion of the allowance current at her death.

The formal way of doing the calculation is this

- Add up everything the first spouse left to people other than his wife.
- Subtract that from the allowance current at the time of his death.
- Divide the answer by the total allowance at the time of his death.
- Calculate the same proportion of the allowance current at the time of the second death.

Hester and Peter were married for 30 years. Peter got cancer and died in May 2005. Before his death Peter and Hester discussed inheritance tax and decided that he would leave the house to Hester and £55,000 in cash to their two children, Annie and Charles. That way they got the £55,000 free of IHT and Hester could manage without the income it brought.

Hester is now ill herself with just a few months to live. If she dies in August 2008 the IHT allowance then will be £312,000. Her home and contents are worth about £450,000. Hester lives on her pensions and has little else of value. Under the old rules Hester's estate would have been £138,000 over the IHT threshold and tax of £55,200 would be due. Under the new rules Hester's executors can look back to Peter's death to see if Hester can add his allowance to hers. At the time he died the IHT threshold was £275,000. He left £55,000 which uses up 20% of that allowance. So Hester's estate can claim 80% of the allowance current at her death — 80% of £312,000 is £249,600. That is added to the standard £312,000 to give a total allowance of £561,600. That is well above the value of the estate so no tax is due on her estate.

Deaths before 18 March 1986

For deaths back to 13 March 1975 the calculation is straightforward. Inheritance Tax replaced Capital Transfer Tax (CTT) on 18 March 1986 but CTT also had a nil rate band and allowed spouses to leave any amount to each other tax free of tax. So the calculation is exactly the same when the first death was under the CTT regime.

James Golding died in June 1980. He left everything to his wife Marigold except £5000 which he left to his two sons, Mark and Rufus. At that time the tax-free

allowance for Capital Transfer Tax was £50,000. So James did not use £45,000 of the allowance. $\frac{£45,000}{£50,000} = 90\%$. So when Marigold dies in the future she will be able to have 90% of the current allowance. If she died this year her estate would have her full allowance of £300,000 and another 90% of that allowance which is £270,000 making a total of £570,000. If her estate was less than that amount her heirs would pay no IHT.

The allowances for IHT and CTT are in Appendix 1.

For deaths before the introduction of CTT on 13 March 1975 the calculation is a little trickier. It is explained in Appendix 1 together with the allowances to use for deaths back to 1914. In such cases it is sensible to ask for help from the Inheritance Tax and Probate helpline on 0845 302 0900 to make sure that you have got the calculation right.

Second and subsequent marriages

Someone who has been widowed more than once can carry forward allowances from more than one husband. However, she cannot accumulate an allowance of more than 100%.

Mary was widowed in her 30s when Sam died in a road accident in 1978. He had left £10,000 to his sister and the rest to Mary. At the time the CTT allowance was £25,000 so he used 40% of it and that left 60% to be inherited by Mary. She remarried and sadly her second husband Kurt died in July 1995. He had children from a previous marriage and left them £77,000. That used half of the £154,000 allowance at the time

passing on 50% to Mary. When Mary dies her heirs will be able to look back to both these past husbands and bring forward 60% from Sam and 50% from Kurt. That would make 110% but under the rules she can only inherit a maximum of 100%. So her heirs can count her own allowance and another full allowance at the time of her death.

Evidence

The new rules mean that exactly what was left in an estate in the past has become an important factor in working out the allowance due on a widow's estate. Evidence for these past events may be difficult to find as family papers will often have been destroyed especially if the first death was many years ago. In many cases estates where no tax was due did not have to be notified to the Revenue and no official records exist.

However, once probate is granted wills are public documents for anyone to see. So if the deceased left a will then a copy of it can be obtained through the court system for a small charge. Contact the Probate Registry in England and Wales, the local Sheriff Court or National Archives in Scotland and the Public record Office in Northern Ireland. See 'further information' below for how to contact them.

If the deceased did not leave a will then the details of who inherited may also be available from those sources. Alternatively a lawyer who dealt with the estate may have kept the papers. If there is no indication of who inherited property then you should assume it all went to the spouse. Before 13 November 1974 it was common for a spouse to be left only have life interest in the property rather than inheriting the

property itself. If she did inherit only a life interest then when she dies the whole estate may be exempt from IHT under special rules which are explained later see 'Older widows'.

Tax planning

The changes to the law in October 2007 reverses almost all the tax planning advice for couples that professional advisers – and *Saga Magazine* – has given over the years. There is no longer any need to split the ownership of the family home between husband and wife or for each to leave their half to their children. There is no longer any need to set up a trust – the so-called 'nil rate band trusts' – to leave your heirs property up to the value of the IHT allowance at your death. All these schemes were intended to make sure the first to die used their IHT allowance. But they are unnecessary now that the first to die can pass on their allowance to count when their spouse dies.

In future the advice to married couples in almost all circumstances is for each to leave everything to their spouse. That will ensure that when the second partner dies their heirs will benefit from two whole tax allowances. Of course, if the value of the estate grows more rapidly than the rise in the IHT allowance then eventually more tax may be due. But that seems unlikely for two reasons. First, the long boom in house prices seems to be coming to an end. Second, the Chancellor promised that in future the IHT allowance would be set having regard to house prices as well as general inflation. So there is a small risk of slightly more tax being due. But the alternative is so complex and costly it is not worth considering.

Spouses who have already split their property and set up one of these trusts should rewrite their wills to leave everything to their spouse. Where one spouse has already died the will can be rewritten within two years of the death as long as all the heirs agree. It is called a Deed of Variation and making one would be the sensible course in most cases. Where the first spouse died more than two years ago it is not possible to rewrite the will and nothing can be done. The old arrangements – which were sensible when they were taken out – will have to stand.

Exceptions

There is one main exception to the general rule that spouses should leave everything to each other. If a woman has a second husband but she will inherit a full allowance from a first husband then it is sensible for the second husband to leave up to his own nil-rate band to his children or other heirs. On his death they will inherit say £300,000 of property free of tax. Then on their mother's death they will benefit both from her IHT allowance and the one inherited from her first husband. So people married to someone who has been married before should consider this option when planning their tax. It may be that splitting property and nil-rate band trusts are not quite dead yet! If that might apply to you see Appendix 2.

There are other circumstances, unrelated to IHT, in which a spouse may want to leave property to other people. For example, someone who has married again might want to leave property to children of their first marriage rather than to their second spouse. In some cases that can be done through a trust so that the second spouse, for example, can continue to live the couple's home but on her death it will pass to the first spouse's children. In such cases you should see a lawyer.

Unmarried couples

The new rules apply to couples who are married or in a civil partnership. Unmarried couples are not helped. From an Inheritance Tax point of view an unmarried couple should marry. That will allow their heirs to benefit from the new rules. Of course, not everyone who lives together can marry – two relatives for example or two people where one is still married to someone else. They should consider their IHT options carefully.

First you should be aware that you can only leave £300,000 before IHT is due. And that includes leaving money or a share of your home to your partner. If the home is worth more than twice the IHT limit then tax could be due on the first death.

Hamish and Fiona have lived together since the 1970s and saw no reason why they should get married. They have no children. Their home in London – modest when they bought it – is now worth £900,000. They own it between them. When Hamish died this year his estate was half the value of the house plus some savings – which are his rather than theirs – making a total of £500,000. His allowance is £300,000 so Fiona would have to pay IHT on the difference of £200,000 which at 40% would cost her £80,000. That is far more than his savings and she does not know where she will get the difference of £30,000. She fears she might have to sell their home to pay the tax.

The Revenue will allow any IHT due on property to be paid off over ten years. If Fiona applies for that concession she will still have to find £3000 a year plus interest which is currently charged at 5% on the unpaid tax.

New laws in Scotland give unmarried couples some rights to each other's property on death or separation. But they make no change to the IHT rules. The Law Commission has suggested similar changes in the law for couples who are not married or civil partners in England and Wales. But these proposals do not include changes to Inheritance Tax law either and it seems unlikely that such a change will be made.

Armed forces

If a person's death was due to active service in the armed forces – or was hastened by it – then their whole estate is completely exempt from inheritance tax. Many people can benefit from this little-known rule. It was used by the executors of the fourth Duke of Westminster in 1967. His family, one of the wealthiest in Britain, successfully claimed his death from cancer had been 'hastened' by a stomach wound he suffered fighting in France in 1944 and paid no inheritance tax at all. But many people of much more modest means can also benefit from this exemption which has existed for more than 300 years. The law is now section 154 of the Inheritance Tax Act 1984. If you think it may have applied to the estate of someone who has already died, you should apply to the capital taxes office for a refund of the tax – plus interest from when it was wrongly paid.

Older widows

A special exemption from IHT applies to the estates of some – but by no means all – women who were widowed before 13 November 1974. Whether the exemption applies depends on how she inherited the property from her late husband. The most straightforward way to inherit is what the lawyers call 'absolutely'. She becomes the

owner of the property and can do what she wants with it. Nowadays this is the normal way for property to be left in a will. The other, more old-fashioned, way to inherit is called an ‘interest in possession’ in the property, sometimes known as a ‘life interest’. That means that for the rest of her life she can live in the family home and have the income from any investments. But legally she is not the owner of the property. It is owned by a trust and when she dies the trust will pass the property on to the heirs, usually her children.

The exemption from IHT **only** applies to widows whose late husband left them a life interest in the property. It does **not** apply to widows who were left the property absolutely. The law is Inheritance Tax Act 1984 Schedule 6 paragraph 2. You can find out how the estate was left from the late husband’s will. If you no longer have a copy you can get one from the local Probate Registry in England or Wales, the local Sherriff’s Court or National Archives of Scotland or the Public Record Office of Northern Ireland. See ‘further information’ below for details of how to contact them.

If a husband died before 13 November 1974 and had no will, then it is possible that under the intestacy rules that then existed some of the property above a certain amount will have been put into a lifetime trust for the benefit of the widow. If so that part of the estate may now be exempt from IHT.

If the widow was left property absolutely and it was below the exempt amount for estates at the time there may still be some allowance that can now be used by her heirs when she dies under the new rules for couples described earlier.

Schemes

Some insurance companies and financial consultants have made a lot of money selling plans to reduce or avoid Inheritance Tax. Such schemes can be complicated – involving juggling the ownership of money or making gifts into or from trusts – and often involve taking out an insurance policy. These schemes are often designed to generate commission for the salesperson rather than benefit you. If the scheme does not work then it is your heirs, not the adviser, who will end up paying the bill. In 2005 the Government clamped down on one kind of scheme leaving 30,000 people, who had paid good money for advice, with a tax bill every year just to carry on living in their own home. And in 2006 major uncertainty was created when the Government announced plans to change the way that trusts were taxed, without any consultation. Later it watered down the proposals but the changes have made deals involving trusts much less attractive. The Government has warned that it will take action against any scheme which is set up just to avoid tax. So generally they are best avoided and will become much less popular now that married couples can pass on their allowance to each other. If you want to consider one, then **before you commit yourself** make sure it has the approval of HM Revenue & Customs, and discuss it with an impartial professional adviser – such as a solicitor or accountant – who you find yourself and who is entirely separate from the company or individual selling the product.

Probate

Many people agree to be an executor of a will but find the details of what they have to do when the person dies rather more than they bargained for. Once a person has died the executors of the estate are responsible for valuing all the assets, assessing and deducting any debts, and for delivering an account of the value of the estate to the

Probate Registry. When they do that they also have to pay any Inheritance Tax which is due. Only then will what is called 'probate' be granted and the estate released so that debts can be paid and the balance sold or distributed among the heirs. The procedure is the same in Scotland but it is called an 'inventory' and has to go to the Sheriff Clerk who grants 'confirmation'. Similar rules apply in both jurisdictions if someone dies without a will; then the next of kin is usually appointed as an administrator to the estate doing the same job as the executors.

If you come across points that you are not sure about you can always take your questions to a lawyer who specialises in this kind of work. They will then charge you by the hour to answer them. You then use that information to proceed with probate. Always use a solicitor who is a member of the Society of Trust and Estate Practitioners (STEP). One question you should always ask when dealing with an estate is whether a Deed of Variation could be used to reduce the Inheritance Tax due.

Any Inheritance Tax due has to be paid before probate (or confirmation) is granted. In other words, the tax has to be paid before the assets can be released to pay it! Some assets of the deceased can be used to pay the tax, including National Savings & Investments products and money in an account at most banks and building societies. But if these assets are not enough – and often they will not be if a house is involved – then the executors have to borrow the money to meet the IHT bill. Some High Street banks will make a short-term loan to the executors to pay the Inheritance Tax. Although the interest rate may be high the loan will only be needed for a short time so the cost will be modest. Make sure that you claim against the estate any interest due on this loan.

If a substantial part of the estate is the value of a property then the IHT due on that part can be paid in ten annual instalments. Interest, currently charged at 5% a year, is due on the unpaid tax.

Although working out liability can be complicated the Revenue expects you to do it within six months. The deadline for paying IHT is six months after the end of the month in which the person died. So if someone dies in November, the IHT has to be paid by the end of May. If it is not then interest on the tax due starts the next day, 1 June. The rate of interest on unpaid IHT is currently 5%. If the IHT is not paid for another six months then penalties may be charged. There are also penalties if the IHT account contains errors.

Solicitors and banks

When you make a will it is better to name the main beneficiaries as executors rather than a bank or solicitor. Although a professional will usually do the job competently they will charge a percentage of the value of the estate – up to 4% on a small estate, less on a larger one. If they charge an hourly rate that is an open-ended commitment and the hours worked – and the cost – are in the solicitor's hands. Either way the charges will reduce the value of the estate to the heirs.

Property abroad

If you move abroad, then property you still own in the UK can be liable to Inheritance Tax here. It may also be liable to tax in the country where you live now and the

Inheritance Tax due there may be much more than you would pay in the UK. It is vital that you make a will under the local jurisdiction when you arrive.

If you live in the UK and you have property abroad that will normally be part of your estate for UK Inheritance Tax.

In either case, there are agreements in place with some countries – though not all – to ensure your estate is not taxed twice. The question of where and how an estate is taxed is very complex and if you have substantial assets in a country where you do not normally live you should seek advice from a lawyer or accountant who specialises in these matters in both jurisdictions.

A spouse who lives in the UK but is not what the Revenue calls ‘domiciled’ here cannot inherit unlimited property from her partner free of IHT. Only the first £55,000 is free of IHT.

More than one death

If someone dies within five years of inheriting property from an estate where Inheritance Tax was due, the tax due on their death can be reduced.

It is called successive charges relief (or sometimes still ‘quick succession relief’) and applies on a sliding scale if someone dies up to five years after inheriting property themselves. It can only apply if they paid tax on that inheritance.

Marjorie Dawes died in January 2004 leaving her house and belongings to her daughter Patricia. The estate was worth £385,000 and £40,000 IHT was paid. Patricia, who is widowed, dies in July 2006, less than three years after her mother's death. Her daughter Gemma inherits all her property. As her mother has already paid IHT on some of the property she inherited, Gemma will get some relief from tax on her mother's estate. The arithmetic is complicated but Gemma will be able to inherit an extra £21,500 without paying tax on it.

If you think you may be in this position always ask the Revenue for advice.

Taper relief

If someone make a large gift, more than the nil rate band, and they die within seven years of making it, then tax is due on that gift and has to be paid by the recipient. If they die within three years full tax is due. But it is reduced by 20% for each year or part of a year over three. If you are in this position seek professional advice.

FURTHER INFORMATION

There is a brief guide to IHT in Revenue leaflet IHT3 *Inheritance Tax: An Introduction*. Copies are available from tax offices or from the Capital Taxes Orderline on 0845 234 1000 or on the website.

You can contact the Revenue's Probate and IHT Helpline on 0845 30 20 900. And there is a useful guide called *Inheritance Tax – How to Calculate Liability* which you can get from HM Revenue & Customs or the website at www.hmrc.gov.uk/pdfs/iht15.pdf.

There is a useful guide to applying for probate in England & Wales on the Courts Service website www.hmcourts-service.gov.uk/courtfinder/forms/pa2_0206.pdf

There is more detailed information on the Revenue website at www.hmrc.gov.uk/cto/customerguide/page1.htm. If you want even more detailed information you should consult the IHT manual which contains the guidance used by Revenue staff. It is at www.hmrc.gov.uk/manuals/ihtmanual/index.htm

The Revenue's capital taxes offices are at

HM Revenue & Customs

Capital Taxes

Ferrers House

PO Box 38

Castle Meadow Road

Nottingham

NG2 1BB

HM Revenue & Customs

Capital Taxes

Meldrum House

15 Drumsheugh Gardens

Edinburgh

EH3 7UG

HM Revenue & Customs

Capital Taxes

Level 3 Dorchester House

52-58 Great Victoria Street

Belfast

BT2 7QL

The Inheritance Tax Act 1984 is available online at

www.hmrc.gov.uk/ihta/index.htm

You can find old wills through the Probate Registry in London

Tel 020 7947 6939. There are also local probate offices – details from

www.hmcourts-service.gov.uk/cms/wills.htm

National Archives of Scotland tel: 0131 535 1314

www.nas.gov.uk or contact the Sheriff's Court near where the deceased lived when they died.

In Northern Ireland contact the Public Record Office tel: 028 9025 1318.

www.proni.gov.uk

The Land Registry website is at www.landreg.gov.uk or you can contact your local Land Registry.

If you want to find a professional to give you help or advice a good place to start is the Society of Trust and Estate Practitioners. Its members are all lawyers and professionals who specialise in sorting out estates and reducing inheritance tax.

www.step.org or call 020 7838 4885 to get a list of local members.

GLOSSARY

Capital Transfer Tax (CTT) replaced Estate Duty for deaths from 13 March 1975.

The lifetime gift part of the tax began on 13 November 1974.

Confirmation (Scotland)

See Probate

CTT – see Capital Transfer Tax

Deed of Variation

A procedure to change a will after a death. All the beneficiaries have to agree and it has to be done within two years of the death. The procedure can be used to reduce Inheritance Tax and to change the way married couples leave their property.

Estate

The property and money left by someone who has died.

Estate Duty a tax on estates introduced in the 19th century. It was simplified in 1949 and replaced by Capital Transfer Tax on 13 March 1975.

Executor

The person appointed in a will to wind up the estate of someone who has died.

Usually a beneficiary of the will, sometimes a professional such as a bank or solicitor.

A female executor is sometimes called an executrix.

Exempt gifts

Gifts made before death that are within the rules to be exempt from Inheritance Tax whenever the donor dies.

Gift with reservation of benefit (GROB)

A gift made before death but which the donor maintains an interest in. Such a gift will still count as part of their estate at death.

GROB

see Gift with Reservation Of Benefit

Inheritance Tax Allowance or IHT Allowance

The informal phrase for **nil-rate band** or **threshold**.

Intestate

Someone who dies without a valid will is said to be intestate.

Joint owners (Scotland)

See Tenants in Common

Joint owners with succession (Scotland)

See Joint tenants

Joint tenants

Where two or more people own a property jointly. On the death of one the other becomes the owner of the whole property.

In Scotland called Joint Owners With Survivorship. See also tenants in common.

Letters of Administration

The equivalent of probate when some dies without a will.

Lifetime gift

Any gift made before death but normally one that exceeds the gifts that are exempt.

See also Potentially Exempt Transfer..

Nil rate band

The threshold at which IHT starts to be due on an estate. Also called the IHT allowance.

Potentially Exempt Transfer

A gift made before death that is not an exempt gift.

Probate

The process of winding up an estate after a death, paying the Inheritance Tax, and getting permission to distribute the assets to the beneficiaries.

Sever joint tenancy

The process of changing the ownership of a property from joint tenants to tenants in common.

Tenants in Common

Two or more people who own a property and where each owns a specific share, usually half, which they can then separately leave to their heirs. In Scotland called Joint Owners. See also Joint Tenants.

Testator

The person who makes a will. If it is a woman she is sometimes called the testatrix.

Threshold

See Nil Rate Band

Trust

A legal arrangement where property is owned or controlled by trustees on behalf of someone else.

Will

The legal document which gives instructions as to how your property is to be disposed of after your death.

Witness

A person who signs a will stating that they have seen the testator signing it.

APPENDIX 1**Historical allowances for death taxes.**

These historical allowances are used to work out the allowance that is left to pass on to a surviving spouse who dies on 9 October 2007 or later. If the first death was on 13 March 1975 or later the position is straightforward as both CTT and IHT allow unlimited inheritance by a spouse. Any bequests to other people use up some of the allowance listed here.

When the first spouse died before 13 March 1975 when CTT replaced Estate Duty the position is slightly more complex. Up to 21 March 1972 no tax-free transfer to a spouse was allowed. So any bequest to a spouse uses up part of the nil-rate band. If the spouse was left £10,000 in, say, 1970 then no nil rate band would be left for her estate to benefit from on her death now. That will cause particular problems for deaths before 10 April 1946 when only the first £100 was exempt.

From 22 March 1972 there were two allowances both of £15,000. A spouse could be left up to £15,000 free of Estate Duty. Another £15,000 was available to leave to anyone else free of ED. Any bequest to a spouse for more than £15,000 uses up some of the £15,000 which could be left tax-free to other people. So if a spouse was left £15,000 or less her bequest does not affect the allowance that is used. If she was left more than £15,000 that uses up some of the tax free allowance. If she was left £30,000 then no tax-free allowance is left at all.

For example, James died in 1973. He left £20,000 to his wife Muriel and £2500 to his son, John. The £20,000 he left to Muriel is tax free using up the £15,000 tax-free

allowance to a spouse and another £5000 of the general allowance. That leaves £10,000 general allowance and another £2500 of that is used up by the bequest to John. So James has used up £7500 of the general £15,000 allowance which is half of it. That leaves half to be passed on to Muriel. If Muriel dies in 2008/09 when the full allowance is £312,000. So she will have her own allowance of that much plus half of £312,000 which is £156,000 making a total of £468,000. If her estate is less than that no tax will be due.

Historical nil-rate band allowances

	Date of death	Allowance
Estate Duty		
16/08/1914	to 09/04/1946	£100
10/04/1946	to 29/07/1954	£2,000
30/07/1954	to 08/04/1962	£3,000
09/04/1962	to 03/04/1963	£4,000
04/04/1963	to 15/04/1969	£5,000
16/04/1969	to 30/03/1971	£10,000
31/03/1971	to 21/03/1972	£12,500
22/03/1972	to 12/03/1975	£15,000*
Capital Transfer Tax		
13/03/1975	to 26/10/1977	£15,000
27/10/1977	to 25/06/1980	£25,000
26/06/1980	to 08/03/1982	£50,000
09/03/1982	to 14/03/1983	£55,000
15/03/1983	to 12/03/1984	£60,000
13/03/1984	to 05/04/1985	£64,000
06/04/1985	to 17/03/1986	£67,000
Inheritance Tax		
18/03/1986	to 16/03/1987	£71,000
17/03/1987	to 14/03/1988	£90,000
15/03/1988	to 05/04/1989	£110,000
06/04/1989	to 05/04/1990	£118,000
06/04/1990	to 05/04/1991	£128,000
06/04/1991	to 09/03/1992	£140,000
10/03/1992	to 05/04/1995	£150,000
06/04/1995	to 05/04/1996	£154,000
06/04/1996	to 05/04/1997	£200,000
06/04/1997	to 05/04/1998	£215,000
06/04/1998	to 05/04/1999	£223,000
06/04/1999	to 05/04/2000	£231,000
06/04/2000	to 05/04/2001	£234,000
06/04/2001	to 05/04/2002	£242,000
06/04/2002	to 05/04/2003	£250,000
06/04/2003	to 05/04/2004	£255,000
06/04/2004	to 05/04/2005	£263,000
06/04/2005	to 05/04/2006	£275,000
06/04/2006	to 05/04/2007	£285,000
06/04/2007	to 05/04/2008	£300,000

From 1946 to 1971 the dates are slightly different in Northern Ireland. Full details here
www.hmrc.gov.uk/cto/customerguide/page15.htm

*From 22 March 1972 there was also a £15,000 allowance specifically for gifts to a spouse.

APPENDIX II**Splitting an estate**

In the past married couples were given complex advice about splitting the ownership of their home and leaving half each to their children. That advice is normally no longer required. But in one limited case it might be. Where a person is in a second (or subsequent) marriage and their spouse can inherit the tax allowance of a previous partner then the other spouse can reduce the tax their heirs pay by making sure they leave them up to the IHT allowance. This appendix explains briefly how to do that.

For example, Jonathan married Mathilda in 1980. She was already a widow having lost her first husband Mick in a works accident. Mick and Mathilda owned their property together and when Mick died Mathilda inherited it all. When she dies her heirs will be able to bring forward Mick's unused tax allowance and Jonathan's up to a maximum total of 100%. However, as Mick's is already 100% there is no advantage in Jonathan's allowance so he might as well use it himself.

He does that by leaving as much as he can to his heirs. If he has free assets that Mathilda will not need then he can leave those to their children up to the value of the nil rate band, currently £300,000. But in fact Jonathan is not that wealthy. And what savings he has he wants Mathilda to enjoy should she die first. Their main asset is their home which is worth around £500,000.

Like most couples Mathilda and Jonathan own their home as what are called 'joint tenants' (in Scotland it is called 'joint owners with survivorship'). When one dies, the other simply becomes the owner of the property without formality. But there is a

different way of owning a home which is called 'tenants in common' (in Scotland they use the much more sensible term 'joint owners'). Under this form of ownership, each partner owns a specific share of the property, usually half each. In that case each partner is free to leave their half of the property to their heirs separately.

In order for Jonathan to leave half the home to the children they must change the way they own it.

In England and Wales you change from being joint tenants to tenants in common by issuing what is called a Notice of Severance. This is simply a document which one of you sends to the other – it does not matter which of you does this – at your home address saying 'I hereby sever our joint tenancy of <address> and in future we shall own that property as tenants in common in equal shares.' Make two copies. Write your name, sign and date both and get your partner to write 'I acknowledge receipt of this Notice of Severance' on both and write their name and sign and date both.

If your property is not registered with the Land Registry that is all you need do. Keep the Notice with the documents relating to your ownership of the property.

If your property is registered – and most of it is now – you must then register the change in the way it is owned with the Land Registry. You have to use a form RX1 'Application to enter a restriction' which ensures that anyone trying to buy the property in future knows there are two owners. There is no charge for this procedure. You can download and print off the form [here](#)

www.landreg.gov.uk/assets/library/documents/rx1.pdf or contact your local Land Registry. This form is used for many different restrictions and was not designed for members of the public to use. As a result it is almost completely unintelligible. Fortunately there is now a guide to filling in the form which you can get here www.landregistry.gov.uk/assets/library/documents/public_guide_018.pdf.

Remember, the form just registers the change of ownership. You still need to issue the Notice of Severance as described above. Keep a copy of the Notice and a photocopy of RX1 with the documents relating to your property. Tell your heirs what you have done.

In Scotland or Northern Ireland you should see a solicitor about making this change.

Dangers

You must each write a will leaving your share of the house to your heirs without conditions. You **must not** specify that the survivor must be allowed to live there. If you do then when the second spouse dies the whole house will be treated as their property. So you have to trust your children. As joint owners any of them could insist it be sold at any time. Even if you trust your children, if any of them divorces or goes bankrupt, then the courts could order the house to be sold to realise their share leaving the survivor with nowhere to live. In addition, the children will own a share of a home which they do not live in and that will count as their capital and could prevent them from claiming Income Support, Housing Benefit or Council Tax Benefit (but not tax credits).

There is another risk to the heirs. On the first death they will become part owners of a home in which they do not live. Any gain in value of the share from the date they inherit to the date they finally sell it will be liable to Capital Gains Tax. The tax due will depend on many factors but it will be less than the IHT which has been saved.

Trusts

There is a way round these problems which still achieves the stated objective. However, it carries risks of its own. Instead of each spouse leaving half the house directly to the children they leave the value of it to what is called a discretionary trust with the children as beneficiaries. On the first death the trust inherits half the house. Instead of insisting on payment, the trustees simply take from the survivor what is in effect an IOU promising to pay the money owed when they die. The trust accepts this IOU and charges no interest. The debt is only repaid when the second spouse dies by passing part of the house to the trust which passes it to the heirs who then own all the house. This legal mechanism stops the children owning any part of the property until the second parent's death. So it does not matter if they divorce, go bankrupt or need to claim means-tested benefits.

The risk is that a future Government will act to prevent what is essentially an entirely artificial arrangement devised solely to avoid IHT. That seems unlikely, but it is not impossible. You can never be sure that a future Government will not act to stop it. The present Government has acted to change the tax rules on trusts that are used for tax avoidance – and made them retrospective. There is also a risk that the Revenue will challenge these arrangements in court.

If you want to make a trust like this it can be done by any competent solicitor when you update your will.

Paul Lewis

8 November 2007