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Inheritance Tax – have your cake and eat it?

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As reported at length, the Chancellor changed the rules for inheritance tax in October. 2007 Previously, the inheritance tax allowance (or nil rate band) of the first partner to die in a marriage or civil partnership was lost if the whole estate was left to the survivor. One could get round this by providing on first death, that a sum up to the nil rate band be put into a discretionary trust, and the survivor and usually children were named as the trust beneficiaries. None of these beneficiaries had an absolute right to the assets and even if the survivor was favoured, the trust assets would not form part of his/her estate on second death.

The new rules give more flexibility. Now, as long as the first to die leaves something to their partner, and in addition, doesn't leave the whole of their nil rate band to someone else, there will be more than one nil rate band available on second death.

In the tax year 07-08 the nil rate band was £300,000. Therefore to illustrate, let's assume a husband died in August last year, leaving £100,000 to his children and the balance of estate to his wife. The husband's estate has therefore used up one third of his nil rate band. When his wife dies, her estate will be entitled to her own nil rate band allowance and the unused 2/3 of her husband's allowance.

Indeed, if the wife gives away assets following her husband's death and then survives for seven years, more tax may be saved. After that period, gifts no longer count towards the cumulative total for inheritance tax and there will still be the nil rate bands available on second death.

Therefore, should those who already have nil rate band trust wills change them? The answer is no. HMRC have conceded that if trust assets are appointed out to the surviving partner after first death, they will treat them as though left directly to the partner in the will, making two allowances still available on second death.

However, where is it still sensible to use these trusts in new wills?

The obvious case is where spouses each have children from a previous marriage and wish to preserve the capital for them, but equally wish the surviving spouse to benefit from the income or to continue living in the matrimonial home. The trust is the perfect vehicle for this.

A second scenario is where there is concern that the whole joint capital might be eaten away if the surviving spouse needs prolonged care - perhaps in the event of early on-set dementia. Using such a trust would allow the trustees to utilise the income generated to contribute towards care costs, but still preserve substantial capital for the next generation.

There are other circumstances where it could be of benefit and you can contact one of our private client team if you would like to discuss this further and to get advice as to whether this might suit your own personal circumstances.

In conclusion a trust may allow you to have your cake and eat it.

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