



Changes to Inheritance Tax Clarified.

Last year's Pre-Budget Report heralded major changes in inheritance tax planning.

On the day of a Pre-Budget Report (PBR) or Budget, it is often the case that detail is lacking and it is difficult to properly analyse the impact of the tax changes. In October last year however, the inheritance tax (IHT) changes for the nil rate band (NRB) were announced with draft legislation. But what are the rules?

To understand what changed, the IHT changes are best illustrated by example. Take Mr. and Mrs. Smith, a married couple. Under the old rules, assume Mr. Smith died and left his entire estate to Mrs. Smith (even in examples we still assume the man died first!) No IHT was due at that point since the spouse exemption applied for IHT purposes.

On Mrs. Smith's later death, her estate was subject to IHT at 40% on the value exceeding the NRB of £300,000 (tax year 2007/08 figure). The net result was that up to £120,000 of extra IHT could be due overall since the NRB of £300,000 was wasted on Mr. Smith's death (since spouse exemption applied to everything he left to Mrs. Smith).

In the new regime, on Mrs. Smith's later death, she would have an NRB of £600,000 on death, not £300,000, assuming Mr. Smith's will contained no other legacies and that Mr. Smith had not made any lifetime gifts within seven years of his death. These two qualifications are important since such legacies or lifetime gifts would have used up some of Mr. Smith's NRB.

The key point to identify here is what percentage of NRB was unused on first death. In the case above, 100% was unused so therefore the estate of the second to die is allocated a 100% increase to the then prevailing NRB. The monetary amount of the first NRB is not carried forward, but rather the percentage unused.

It is important to note that the new rules would apply not just if Mr. Smith died after 9 October, but also at any time before 9 October. This new rule however only applies if the second death occurs after 9 October.

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18-20 Stamford Street, Stalybridge, Cheshire, SK15 1JZ.
Tel: 0161 303 9977, Fax: 0161 303 8499, E-Mail: answers@arkfp.co.uk.
Registered in England: No. 4975240.
Registered Office: 14 Warrington Street, Ashton-under-Lyne, OL6 6AS.