INHERITANCE TAX MADE SIMPLE

ANDREW KOMARNYCKYJ

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Inheritance Tax Made Simple

The essential guide to understanding inheritance tax

by Andrew Komarnyckyj

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Disclaimer

Please note that this book does not replace the need to take legal and/or financial advice from a qualified expert when making tax-planning arrangements. Indeed, this book recommends that such advice is sought and taken.

Every effort has been made to ensure that the contents of the book are accurate when going to press. However the accuracy of the contents cannot be guaranteed. Inheritance tax, like all taxes, is frequently subject to change.

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About the Author

Andrew Komarnyckyj is the director of a niche legal practice delivering innovative legal services to the public and to other professionals. He had a successful career in sales and marketing prior to qualifying as a solicitor.

He studied law by correspondence course while working full-time, and was awarded two prizes for achieving the highest marks nationally in one of his law exams.

During his legal career he has been the head of the probate department for two leading West Yorkshire firms of solicitors, at one of which he became a partner. He has over 15 years' legal experience working exclusively in the field of wills, trusts, tax planning and probate.

He left conventional legal employment in March 2009 in order to establish Wills, Probate and More (**www.willsprobateandmore.co.uk**), his own niche legal services company, and to be free to comment on the legal profession as an outsider. He now divides his time between legal practice and writing. Andrew is also the author of *Probate Made Simple* (Harriman House, 2010).

Abbreviations

For a detailed glossary, see Appendix 3 on page 188.

AIM	Alternative Investment Market
APR	agricultural property relief
BPR	business property relief
CP	civil partner/civil partnership
CGT	capital gains tax
DOV	deeds of variation
EEA	European Economic Area
FLIT	flexible life interest trust
GROB	gift with a reservation of benefit
HMRC	Her Majesty's Revenue & Customs
IFA	independent financial advisor
IHT	inheritance tax
IHTA	Inheritance Tax Act
IIP	interest in possession
IPDI	immediate post-death interest
NICs	National Insurance Contributions
NRB	nil-rate band
PET	potentially exempt transfer
POAT	pre-owned assets tax
PR	personal representative
USM	Unlisted Securities Market
VOA	Valuation Office Agency

Preface

The main aims of this book are:

1. to help you to understand inheritance tax (IHT) and how it could impact on you and your family (Part 1)
2. to detail options you may have for reducing the burden of inheritance tax, set out in a practical way that is accessible to the general reader (Part 2 and 3)
3. to help you to get the most from your tax advisor – whether you use a solicitor, accountant or Independent Financial Advisor (IFA) – if you engage one (Part 4).

Note that inheritance tax may be imposed on all of your assets worldwide if you are domiciled in the United Kingdom (UK), and on your UK assets even if you are not domiciled in the UK. This applies to all areas of the UK, i.e. England, Wales, Scotland and Northern Ireland.

Understanding IHT

With regard to (1) and (2) above, many people will not find it necessary to have a comprehensive knowledge of the IHT regime in order to understand how IHT will impact on them and what measures they might take to mitigate the tax. For example, if you do not own a farm and you are unlikely ever to own farmland, you may not need to get to grips with the concept of agricultural property relief.

However, the majority of people reading this book should nevertheless acquaint themselves with Part 1 before reading the other sections that deal with tax planning, the administration of estates, and so on. In particular, all readers should consider and understand the following before even considering the tax planning content of the book:

- The Executive Overview of Inheritance Tax Regime (page xvi)
- IHT in a nutshell (transfers of value) (1.2) (page 2)
- The nil-rate band and the rate of IHT (1.5) (page 7)

- The spouse/civil partner exemption (1.8) (page 10)
- The transferable nil-rate band (1.9) (page 12)

If you read this book before seeing a tax advisor (even if you read only the narrative text and do not bother going through all the calculations) it is likely that you will save your advisor time explaining things to you; you will also have a better appreciation of his proposals (and may even have a few of your own), and will probably save money in legal and/or accountancy fees (typically charged out at upwards of £200 per hour for this kind of advice).

Inheriting wealth

If you are a beneficiary in a will (or under an intestacy, i.e. where there is no will) and you are due to receive inherited wealth that is subject to inheritance tax, there is often nothing that can be done to mitigate the situation. However, there are circumstances in which action is possible and this book will draw your attention to some of the circumstances in which you will have opportunities to reduce or eliminate the tax on your inheritance.

Administering an estate

If you are an executor or administrator and you are administering an estate that may be subject to inheritance tax, this book will help you and possibly save you money by signposting the main problems that could arise.

Calculations of IHT made in this book

There is an exemption from inheritance tax known as the £3,000 annual exemption (explained at 1.16.1.1). This has been ignored in the calculations, in order to make the calculations clear and easy to follow.

References

The legal basis for IHT is set out in an Act of Parliament called the Inheritance Tax Act 1984 (IHTA 1984). This has been added to and amended over the years by a number of other acts known

as Finance Acts. In addition, the tax has been shaped by legal cases in which taxpayers have appealed against decisions made by Her Majesty's Revenue & Customs (HMRC).

HMRC has issued manuals to provide guidance to tax inspectors. One such manual is the HMRC *Inheritance Tax Manual*, which can be accessed online (at **www.hmrc.gov.uk**) by the taxpayer. It provides useful information on (amongst other things) the HMRC interpretation of tax law*.

On occasion, the IHTA 1984 and the HMRC manual have been cited where it is thought that they might be of interest, or shed some light on a particular point being made.

Inheritance tax touches some of the most sensitive areas of any legal subject, and dealing with it can often be unduly stressful, or come at a difficult time in the life of yourself or of loved ones. It is my hope that this book is a helpfully straightforward and thorough guide to this complex area of law, and that it lessens such stresses as far as is possible.

Andrew Komarnyckyj

Huddersfield, 2010

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*Subject to the following caveats:

"... it should not be assumed that the guidance is comprehensive nor that it will provide a definitive answer in every case. HMRC are expected to use their own judgement, based on their training and experience, in applying the guidance to the facts of particular cases. In particular difficult or complex cases they are able to obtain further guidance from specialists in Head Office.

"The guidance in these manuals is based on the law as it stood at date of publication. HMRC will publish amended or supplementary guidance if there is a change in the law or in the Department's interpretation of it. HMRC may give earlier notice of such changes through *Tax Bulletin* or a press release.

"Subject to these qualifications readers may assume that the guidance given will be applied in the normal case; but where HMRC considers that there is, or may have been, avoidance of tax the guidance will not necessarily apply.

"Neither this guidance nor its publication affects any right of appeal a taxpayer may have..." (Quoted from the *Introduction to Her Majesty's Revenue & Customs' Guidance Manuals*.)

Introduction

Inheritance tax was introduced by the Inheritance Tax Act 1984, which came into effect in 1986. It replaced a similar tax regime known as Capital Transfer Tax, which itself was the successor tax to Estate Duty.

It could be argued that inheritance tax is not a tax of any great importance to the UK economy. The tax take it delivers is low in comparison with some other taxes, and it amounts to a very small proportion of the overall tax take. For instance, in the year 2009-10, inheritance tax raised £2,396 million. This sounds impressive until other taxes are considered – income tax raised £144,881 million; National Insurance Contributions (NICs) raised £95,519 million.

The overall tax take in the UK (including NICs) in 2009-2010 was £408,496*. Inheritance tax accounted for only 0.586% of this figure.

Despite this, inheritance tax is important politically. There is probably no other tax that sets out so overtly to tax wealth. The very name of the tax is probably anathema to many people (it has often been popularly renamed the 'Death Tax').

In the year that this book was written (2010) inheritance tax came into the public eye due to a number of developments. The UK economy was said to be in a parlous state, with an excessive budget deficit. One of the measures taken by the Labour government to address this situation (announced in March 2010) was the retention of the inheritance tax nil-rate band at the level of £325,000 for the next four years. The nil-rate band (NRB) is the amount of an estate exempt from paying inheritance tax, and normally rises every year roughly in line with inflation; it had been set to rise to £350,000 in the year 2010-2011.

*The figures in this section are all taken from official HM Revenue and Customs statistics.

During their election campaign the Conservative Party included in their manifesto a proposal to increase the nil-rate band to £1,000,000, but the election result left them unable to put the proposal into effect. Their plans on inheritance tax featured amongst the compromises with their coalition partner, the Liberal Democrats.

Given the acknowledged need to put the country's finances in order, it appears likely that inheritance tax will remain at the present level for the duration of the current government. But please don't hold me to that!

Executive Overview of the Inheritance Tax Regime

The aim of this overview is to give you a working knowledge of inheritance tax (IHT) with the least amount of reading needed on your part.

- Inheritance tax is a tax that tends to be charged on wealth given away by someone, mainly when it is given away on death.
- In some circumstances it may be charged on gifts made during a person's lifetime.
- The charge on death is imposed at the time of death (however, a period of grace is permitted in which to allow the executors of the deceased to raise funds to pay the tax).
- The charge on a gift made during the deceased's lifetime (simply, a 'lifetime gift') is imposed at the time the gift is made, if the gift is made into a trust rather than to another individual. Such a gift is called a 'chargeable transfer'. An additional charge may be imposed on a chargeable transfer if the donor of the gift dies within seven years of making it. If the gift is made to another individual rather than to a trust, it is referred

to as a 'potentially exempt transfer' (or PET) and tax will only be payable on it if the donor of the gift dies within seven years of making the gift.

- On death, the first £325,000 in value of the money, property and assets owned by a deceased person (known as his "estate") is tax-free. The tax-free amount is known as the nil-rate band.
- Anything above the nil-rate band figure of £325,000 is taxed at the rate of 40%. E.g. if a person died in October 2009 leaving an estate of £425,000, the IHT that would be payable would be £40,000. (40% of £100,000).
- The nil-rate band figure changes from time to time, usually annually to reflect inflation (see Appendix 1).
- Lifetime gifts made within the seven years prior to death are added to the death estate and subjected to inheritance tax. E.g. if the person in the above example had made a gift of £100,000 to his son in September 2009, the gift would be added to his estate for inheritance tax purposes, producing a taxable amount of £525,000 and a liability to inheritance tax of £80,000.
- In exceptional circumstances (explained in 1.15.5) lifetime gifts made within 14 years prior to death may be added to the death estate and subject to IHT.
- The nil-rate band figure is usually increased each year.
- Because of the state of the economy and the need to raise taxes, the NRB may remain at the current level of £325,000 for some years to come.
- Lifetime gifts and transfers of estates between spouses and civil partners are free of IHT. This is known as the spouse exemption. (E.g. if a husband were to die and leave his wife £100,000,000, this would be tax-free because of the spouse exemption). Exception: if the spouse/civil partner is not UK-domiciled, the spouse exemption is limited to £55,000.

- The nil-rate band can be used up by a person during his or her lifetime. If it is used up, there will be no nil-rate band available on his or her death. It will be used up if that person makes gifts during the last seven years of his or her life which amount in total to the value of the nil-rate band or more than the value of the nil-rate band. If the gifts add up to less than the value of the nil-rate band, the nil-rate band will be partly used up. Gifts by a non-UK domiciled individual to a spouse or civil partner where the spouse or civil partner is UK-domiciled will not use up or reduce the nil-rate band, nor will gifts to UK charities and political parties.
- If the deceased is a surviving spouse or civil partner, his or her executors/administrators may be able to claim any unused nil-rate band of his or her predeceased spouse or civil partner. E.g. Tom died in September 2009 with a full nil-rate band because he had not made any gifts. Tom's wife Cecile, who had also not made any gifts, died in 2005 with a full nil-rate band and left her entire estate to Tom. Tom's executors/administrators should be able to use Tom's nil-rate band of £325,000 and transfer the unused nil-rate band of Cecile to use against the value of his estate, so that Tom's estate gets the benefit of £650,000 free of IHT. (Two nil-rate bands of £325,000 each).
- If a person makes a gift to a trust or to a company during his lifetime, this will usually be a chargeable transfer. This means that, if the gift exceeds the nil-rate band, the value of the gift above the nil-rate band is immediately chargeable to IHT at half the lifetime rate (currently 20%, i.e. half the 40% referred to above). If the person who made the gift dies within seven years of making it, further tax may become payable on the gift. If he survives the gift by seven years, no further tax will be payable.
- If a person makes a gift to another individual during his lifetime, this will be a PET. This means that, if the value of the gift exceeds the nil-rate band and he survives for seven years after making the gift, no tax will be payable on it. If he dies

within seven years, IHT will be payable. However, his executors/administrators may not have to pay the full charge to tax. They may be entitled to relief (known as 'taper relief') depending on how long the donor survived after making the gift (as explained in detail in 1.15.3).

- Lifetime gifts that are not taxable on death are:
  - gifts of less than £3,000 in value *made in any one year* (or £6,000 in value if the £3,000 from the previous year has not been used)
  - normal expenditure out of income (e.g. the payment of school fees or premiums on life insurance policies or on occasion money paid to support someone else)
  - gifts of £250 or less to different beneficiaries
  - gifts to UK charities and political parties (gifts and transfers of estates to UK charities and political parties are free of IHT, whether they take place on death or as lifetime gifts).
- There are various exemptions and reliefs available, e.g. business property relief (BPR – dealt with at 1.17.1), available at the rate of 100% on some business assets and at 50% on some other business assets. Agricultural property relief (APR – dealt with at 1.17.4) is available at the rate of 100% on the agricultural value of certain agricultural property.

Part 1
A Detailed Overview of the Inheritance Tax Regime

1.1 A reminder

The majority of people reading this book should acquaint themselves with this Part before reading the other sections of the book that deal with tax planning, etc. In particular, all readers should consider and understand the following before proceeding further:

- The Executive Overview of Inheritance Tax Regime (in the Introduction)
- IHT in a nutshell (transfers of value) (1.2)
- The nil-rate band and the rate of IHT (1.5)
- The spouse/civil partner exemption (1.8)
- The transferable nil-rate band (1.9)

Please bear in mind that reducing the burden of tax on your estate should be secondary to other objectives such as maintaining the lifestyle that you desire.

1.2 IHT in a nutshell (transfers of value)

Inheritance tax (often abbreviated to IHT) is essentially a wealth tax that is charged when wealth changes hands.

It is a tax that is charged principally on death. This is because the biggest transfer of wealth usually occurs on death. Inheritance tax may be charged during a person's lifetime, but the occasion when it is charged most often is on death.

The technical legal term for the tax is that it is a charge on a 'transfer of value'.

This begs the question of what is a 'transfer of value'?

A transfer of value is what happens when you dispose of something of value (e.g. money), and you are worth less than you were before you disposed of it.

A transfer of value has three ingredients:

1. There must be a transfer. A transfer means the passing of something, usually ownership rights, from an individual.
2. The transfer must be of value. Value means money or something of monetary or material worth. The transfer must therefore reduce the value of the estate of the transferor.
3. The transfer must be gratuitous. I.e. the person who makes the transfer must not have received money or any other benefit for it; and the person in receipt of the value must not have paid for it.

An easy way to understand the concept is that a transfer of value is what happens when you give away money, property or assets. You can give away some of your money, property and assets during your lifetime whenever you want, and you will inevitably give away all of your money, property and assets on death.*

*The transfer on death would not be a transfer of value were it not for a mechanism in the Inheritance Tax Act 1984 which artificially introduces a deemed transfer of value on death of everything a person owns: "On the death of any person tax shall be charged as if, immediately before his death, he had made a transfer of value and the value transferred by it had been equal to the value of his estate immediately before his death." (IHTA 1984 s4 (1))

Hence IHT can be charged while you are alive or on your death. However, as will be explained later, most gifts or "transfers of value" that you make during your lifetime are unlikely to be subject to inheritance tax.

Inheritance tax is charged on the value of the transfer – i.e. the amount by which the value of the transferor's estate is reduced.

Inheritance tax is not charged if you sell something to somebody else for the full market value, as there will have been no transfer of value between you and the purchaser. You and the purchaser will both own the same amount of value as you owned prior to the sale; but you will have exchanged an asset for the cash value and the purchaser will have exchanged his cash for the value of the asset.

Inheritance tax may be an issue if you buy an item for more than it is worth, as in those circumstances you will have transferred value to the vendor. (The difference between what the item is worth and what you have paid for it will amount to a transfer of value on your part.) However, you are unlikely to find that IHT is an issue merely because you have made a bad bargain with someone!

Although for most practical purposes a transfer of value can be thought of as being equivalent to a gift, or the transfer of wealth on death, it is important to be aware that transfers of value can include any or all of the following:

- all direct gifts of money, property or assets from one person to another
- all direct gifts of money, property or assets from one person to a trust
- all sales of property for less than the market value if the property was not sold on the open market (e.g. if a parent sold a house to his or her child at less than the full market value)
- granting a lease for less than the full market value
- re-arranging the shares in a private limited company
- agreeing to act as a guarantor for someone else's debts

- paying premiums on a policy of life assurance for somebody else's benefit
- failing to exercise a right you have and thereby reducing the value of your estate.

This list of transfers is not necessarily comprehensive. There may be other circumstances in which a transfer will take place.

The remainder of the book will often refer to "transfers of value", or simply to "transfers". If you find this confusing, you can refer to this section to refresh your memory on what a transfer consists of and what might be defined as a transfer.

Summary

Inheritance tax is a tax on the transfer of wealth on death and on transfers of wealth made within seven years of death. Technically these are known as "transfers of value" and include gifts and many other forms of transfer.

For most practical purposes, and for most people, a transfer of value will be either a gift or the transfer that takes place on death.

Two factors account for the reason that the tax is most commonly encountered on death:

1. the way that the tax is imposed (which is on transfers of value); and
2. the fact that death is the time that most people make their largest transfers of value – everything they possess.

1.3 The meaning of domicile

It may be important to have a basic grasp of the meaning of the word "domicile", as your domicile can have a bearing on how IHT will be charged on your money, property and assets.

"Domicile" is a word which refers to the country in which you have your permanent home, or are presumed to have your permanent home.

You will be domiciled in the UK if the following all apply:

- your parents are and always have been UK citizens
- they have (or had, if they have predeceased you) their permanent home in the UK
- you were dependent on them until you became an adult
- your parents always remained in the UK (other than for holidays!); and
- you were born in the UK and have lived here ever since.

Or if the following all apply:

- your parents were married prior to your birth
- your father is or was a UK citizen
- he had his permanent home in the UK
- you were dependent on him until you became an adult
- he always remained in the UK (other than for holidays!); and
- you were born in the UK and have lived here ever since.

Or if the following all apply:

- your parents were not married
- your mother is or was a UK citizen
- your mother had her permanent home in the UK
- you were dependent on her until you became an adult

- your mother always remained in the UK (other than for holidays!); and
- you were born in the UK and have lived here ever since.

If the above do not apply to you, then refer to 1.14.

Note about UK domicile

Strictly speaking, it is not possible to be domiciled in the UK. Your domicile may be in the legal jurisdiction of England and Wales, Scotland or Northern Ireland, but not the UK. However, in the interests of simplifying matters, we can consider the matter in terms of UK domicile. Even the Inheritance Tax Act 1984 does so (s18 IHTA 1984 uses the expression "... *domiciled* in the United Kingdom...")

1.4 The geographical ambit of IHT

'Ambit' simply means scope.

If an individual is domiciled in the UK, IHT is applied to all his money, property and assets wherever in the world they may be situated.

If an individual is not domiciled in the UK, but is nevertheless deemed to be domiciled in the UK by the operation of the law (i.e. under the criteria of 1.14), IHT is applied to all his money, property and assets wherever in the world they may be situated.

If an individual is not domiciled in the UK, IHT only applies to such of his money, property and assets that are located in the UK.

1.5 The nil-rate band and the rate of IHT

The easiest way to get to grips with inheritance tax is to consider what happens on death. If you read the executive summary earlier, some of this should be getting familiar to you now.

On a person's death, the first £325,000 of what he or she owns can be transferred to his or her heirs tax-free; this is known as the nil-rate band (often abbreviated to the NRB). Everything above the figure of £325,000 is taxed at the rate of 40%.

Example

If a George had money, property and assets (an 'estate') with a value of £425,000, and died in 2010, £325,000 would pass free of tax to his heirs; the remaining £100,000 would be taxed at the rate of 40%, giving rise to an inheritance tax charge of £40,000.

Note that inheritance tax is not just charged on the assets that are transferred on death. *It is also charged on assets that are transferred within seven years of the date of death. In exceptional circumstances* (explained in 1.15.5) *it may even be charged on assets transferred up to 14 years prior to the date of death*. The value of such gifts is added to the value of the assets held by the deceased at death, then the total value is subjected to inheritance tax. This is known as 'cumulation'.

Example

If George gave away the sum of £200,000 to his son Eric in 2009, then died in 2010 owning £425,000 which he left to his daughter in his will, the charge to inheritance tax on death would be based on a figure of £625,000 rather than £425,000, as follows:

	£
Value of George's Estate:	425,000
Add: gift to Eric:	200,000
Total:	625,000
Less: NRB:	(325,000)
Value to be taxed:	300,000

£300,000 @ 40% = £120,000.

Note that the nil-rate band has not always been £325,000 and it is unlikely to remain at £325,000 for long. It usually rises each year, roughly in rise with inflation.

At the time of writing, the NRB is £325,000.

In the tax year April 6 2008 to April 5 2009 it was £312,000.

In the tax year April 6 2009 to April 5 2010 it was £325,000.

In the tax year April 6 2010 to April 5 2011 it will remain at £325,000. (In fact it may remain at £325,000 until 2014.)

Appendix 1 provides details of nil-rate bands going back to 1914.

It is worth taking note of what the words 'nil-rate band' actually mean. The nil-rate band could have been called (for example) the 'tax-free band', or the 'exempt band', as this is what it appears to be. However, appearances may be deceptive. The nil-rate band is a band with a rate of tax at 0%. This perhaps leaves the door open for a future government to change it from the nil-rate band to (for example) 'the 5% rate band'.*

*The IHTA 1984 s7 states that: "the tax charged on the value transferred... shall be charged at the... rate or rates applicable to that value under the...Table in Schedule 1 to this Act..." The table in Schedule 1 refers to a rate of 0% and a rate of 40%.

Technical terms have been avoided in this book as far as possible, but nevertheless the remainder of the book will use a number of words you may not be accustomed to hearing. These are explained in the Glossary at the end of the book, but it is worth reminding you of the main ones you have encountered up to this point.

Estate	This refers to the money, property and assets that a person owns. It includes everything he possesses – shares, bank accounts, his house, etc.
NRB	The value of the money, property and assets that can be transferred (e.g. on death) at a rate of tax of 0%
Transfers of value or transfers	A transfer (in the context of IHT) means the passing of legal rights, usually ownership rights, from one person to another. Value in this context means money or material worth.

These concepts are explained in 1.2 'IHT in a nutshell'.

1.6 The ticking seven-year clock

You will observe from the examples in 1.5 that if you make a gift in the last seven years of your life, it can effectively reduce the nil-rate band available at your death. For example, if you make a gift of £325,000, and you die within a year, there will be no nil-rate band. Your entire estate will be taxed at 40%.

The activation of this reduction of the NRB will last for seven years after a gift is given, after which your nil-rate band will not be affected.

Example

George makes a gift of £200,000 cash in 2002. This reduces the nil-rate band available at his death by the figure of £200,000.

On the seventh anniversary of the gift, in 2009, his nil-rate band is restored to the full amount available.

1.7 Many nil-rate bands

Because of the seven-year clock referred to in 1.6, the nil-rate band could be considered as being available for use once every seven years, although we routinely consider it as available just once, on death.

Example

Sam is aged 50 in 2010. He decides to make a gift amounting to the full value of the nil-rate band on his 50th birthday, and every seven years after that until he is 71. By the age of 71, he will have made four gifts each amounting to his full nil-rate band. Assuming that the nil-rate band will remain at its current level of £325,000, he will have given away £1,300,000 tax-free by his 71st birthday.

When he dies aged 80, he still has the full nil-rate band available to offset against the value of his estate at death, because more than seven years have elapsed since the date of his last gift.

1.8 The spouse/civil partner exemption

We have seen how transfers of value are taxed at 0% up to the value of the nil-rate band (currently £325,000) and at 40% for transfers above that value.

Transfers of value between husband and wife, or civil partners (CP), are exempt from inheritance tax. This is known as the spouse/civil partner exemption.

Example

Gill dies leaving everything she owns to her husband Sam. Her estate is valued at £1,000,000. There is no inheritance tax payable on the estate, even though it exceeds the value of her nil-rate band of £325,000.

Since husbands and wives and civil partners often leave everything they own to one another, the effect of the spouse/civil partner exemption is that in most cases there is no inheritance tax payable on the death of the first spouse or a civil partner; it is only on the second death, as a rule, that inheritance tax will become an issue. How to deal with this point is covered in 1.9.

Planning issue

Transfers between spouses where one of them is not UK domiciled are only exempt to the extent that they do not exceed £55,000.

A UK domiciled spouse can only give his non-UK domiciled spouse a maximum of £55,000 free of IHT. And when this £55,000 spouse exemption has been used up, it is gone forever, unlike the nil-rate band. It will not be available again in seven years. Further transfers above and beyond the £55,000 spouse exemption limit from the UK domiciled spouse will be subject to IHT. However, the nil-rate band will be available in the usual way, to offset against the value of any such transfers.

By contrast, a non-UK domiciled spouse can give his UK domiciled spouse *any amount free of IHT*, thanks to the full spouse exemption.

1.9 The transferable nil-rate band

Because of the spouse/CP exemption (1.8), if a spouse or CP were to die leaving everything to his or her surviving spouse or CP, there would be no inheritance tax to pay.

However, IHT would be an issue on the death of the surviving spouse or CP.

When the surviving spouse or CP died, the first £325,000 of his or her estate would be tax-free due to the nil-rate band, and the remainder would be taxed at the rate of 40%, just like that of a person who died having been single throughout his or her life.

However, the possibility exists to make the situation more favourable.

Since 9 October 2007, it has been possible to transfer the nil-rate band of the first spouse or civil partner to die to the estate of the surviving spouse or civil partner when they die.

Note that the transferable nil-rate band cannot be used to mitigate IHT due on lifetime gifts made by the surviving spouse at the time that they are made. It can only be used to mitigate the tax due at the time of death.

It perhaps should be stressed that it is the nil-rate band, and only the nil-rate band, that can be transferred. The lifetime exemptions mentioned in the Executive Overview and detailed in 1.16.1 cannot be transferred between spouses.

Example

Joan dies in 2010. She has an estate valued at £550,000. The charge to inheritance tax is £90,000.

This is calculated as follows:

	£
Value of Joan's Estate:	550,000
Less: NRB	(325,000)
Estate taxed at 40%	225,000
£225,000 @ 40%	90,000

Joan was predeceased by her husband Phillip, who died in 2001. Joan's personal representatives can apply to HMRC Capital Taxes Office using the appropriate form (currently IHT 402) to transfer Phillip's nil-rate band forward for use against the value of her estate, and, if they do so, no inheritance tax will be payable.

	£
Value of Joan's Estate:	550,000
Less: 2 x NRB	(650,000)
Estate taxed at 40%	Nil

Planning issues

1. The nil-rate band can only be transferred where the death of the *second* spouse or civil partner to die occurred on or after 9 October 2007.
2. The *full* nil-rate band can often be transferred where the death of the *first* spouse or civil partner occurred after 13 March 1975.
3. There may be a nil-rate band to transfer where the death of the *first* spouse or civil partner occurred between 21 March 1972 and 12 March 1975.
4. In some cases there will be a nil-rate band to transfer where the death of the first spouse occurred before 21 March 1972. Prior to 21 March 1972, if a husband or wife left assets to his or her spouse (or anyone else) those assets were taxable. If the assets exceeded the nil-rate band in force at the time, there will be no nil-rate band available to transfer. If they were less than the nil-rate band at the time, there could be a partial or entire nil-rate band to transfer.
5. The above limitations on the transferability of the nil-rate band arise from the changes to the tax regime that have taken place over the years. Prior to 13 March 1975 the tax we now know as inheritance tax was called estate duty and under the estate duty regime there was no general exemption for transfers between spouses, with the result that the nil-rate band could be used up by a transfer from husband to wife and vice versa.
6. Strictly speaking, it is not the nil-rate band that can be transferred, but the unused portion of the nil-rate band. In most cases the full amount of the nil-rate band will be available for transfer (because everything was left to the spouse), but in some cases all or part of it may have

been used up. (E.g. If Phillip had made gifts to someone other than his wife which used up his nil-rate band prior to his death.)

7. The unused portion of the nil-rate band of the first spouse or civil partner to die is taken as a percentage and applied to the nil-rate band prevailing at the date of death of the second spouse or civil partner to die. E.g. if the first death occurred in 2007, when the nil-rate band was £300,000, and the first spouse had used up half of this by giving some things away, the transferable nil-rate band on the second death (if that was in 2010) would not be 50% of £300,000, it would be 50% of £325,000 = £162,500.

8. The transferable nil-rate band is not transferred automatically. The transfer must be requested by the personal representatives of the surviving spouse or civil partner. Note: The personal representatives are the individuals who deal with the affairs of the deceased person on whose estate the tax is liable. If there is a will, the personal representatives will usually be the executors named in the will; if there is no will (i.e. if the deceased died intestate) the personal representatives will usually be the relatives entitled to the estate under the rules of intestacy. The personal representatives must apply to HMRC Capital Taxes Office in Nottingham to have the nil-rate band transferred, using the appropriate form, currently known as an IHT 402. They have two years from the date of death of the second spouse or civil partner in which to request the transfer of the unused portion of the nil-rate band of the first spouse or civil partner to pass away. If they miss this deadline, they will not be permitted to transfer the nil-rate band and the consequences could be disastrous. (E.g. in the case of Joan's estate, discussed

above, missing the deadline would mean the avoidable and unnecessary payment of £90,000 in IHT!) Note that what is transferred is the unused portion of the nil-rate band at the death of the first spouse to die. This unused portion cannot be restored to a full nil-rate band by the passage of time, no matter how long it is before the second spouse dies.

9. The transferable nil-rate band can only be used in respect of transfers on death, not lifetime transfers. To recap: if the surviving spouse makes lifetime gifts which are immediately chargeable to inheritance tax, the transferable nil-rate band cannot be used to mitigate the tax that is immediately payable. The transferable nil-rate band can only be transferred when the second spouse dies. It may then be used to mitigate all the tax payable on his estate, whether imposed in respect of his death estate or in respect of gifts made during his lifetime.
10. It is important to appreciate that the transferable nil-rate band is an *additional* nil-rate band which is *independent of* the nil-rate band of the surviving spouse.
11. The official form which is used to transfer the unused portion of the nil-rate band is currently known as the IHT 402.

1.10 Using up the transferable nil-rate band

The amount of nil-rate band available to transfer depends on the extent to which the spouse or civil partner who dies first has used up his or her nil-rate band by making transfers. These transfers could be made either as lifetime transfers in the seven years prior to their death (as we have seen, these would usually be gifts) or transfers on death.

The transfers on death could be made directly by the first spouse/CP in their will; or by the surviving spouse/CP in what are sometimes called "post death rearrangements".

> Post death rearrangements are arrangements which alter the way that an estate is distributed. For example, if you were given a sum of money by means of a gift from a will, you could make legal arrangements to have the sum of money given to your children instead of to you. If you made these arrangements in a certain legally compliant way, the gift of money to your children would be treated for tax purposes as if it had been made directly by the will to your children, rather than (as was really the case) by you. The legally compliant way would usually be by means of a document known as a deed of variation. This is all dealt with more fully at 3.2 and 3.3.

Transfers on death which reduce the value of the transferable nil-rate band are any dispositions of money, property or assets of any kind *which are given to anyone other than to an exempt beneficiary such as the surviving spouse or civil partner**.

Example

The nil-rate band was £200,000 in the tax year 1996-7. Syd died in July 1996, having made a lifetime gift of £50,000 in June of that year to his son Bert. On his death he therefore had 75% of his nil-rate band available.

In his will, Syd left a further £50,000 to Bert and the rest of his estate to his wife Rose.

The legacy of £50,000 to Bert used up a further 25% of Syd's nil-rate band. He then had 50% left.

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*Exempt beneficiaries include charities and political parties. A gift to a charity or political party will not use up the nil-rate band (see 1.16).

Rose signed a deed of variation (this is a "post death rearrangement" as explained above) which varied the terms of Syd's will, giving yet another £50,000 to Bert. This used up another 25% of Syd's nil-rate band.

All told, Bert has received £150,000 from Syd's estate, which amounts to 75% of Syd's nil-rate band.

When Rose died in 2010, her executors could transfer the unused 25% of Syd's NEB to her estate. As the nil-rate band in 2010 was £325,000, there was £81,250 (25% x £325,000) available for them to transfer.

1.11 Multiple transferable nil-rate bands?

If an individual was married (or in a CP) and widowed, then married a second time, they would have an unused nil-rate band available from the death of their first spouse *and* potentially a further one available from his or her second spouse. You might think this would give them the possibility of having the advantage of three nil-rate bands – £325,000 x 3 (£975,000) free of tax. Sadly not.

Any one individual is only permitted to have the **value of one** *additional nil-rate band at death. However, this value may be accomplished through the use of more than one transferable nil-rate band. So an individual who has been widowed twice over may be able to take advantage of the transferable nil-rate bands of both his wives who have predeceased him in order to make up the value of one full transferable nil-rate band.*

The two nil-rate bands of the spouses who have predeceased can be used to make up the value of a single additional nil-rate band.

This means that if there is any surplus above and beyond the value of a single transferable nil-rate band, it may go to waste. (But note 1.12.3.)

Example

Paul was married to Kitty. Kitty died before Paul, with her full nil-rate band intact. If Paul died without remarrying, his executors would have his nil-rate band and that of Kitty to offset against the value of his estate.

If Paul remarried and survived his second wife, who also had a nil-rate band available, the total amount of nil-rate band available to Paul's executors would still only be two nil-rate bands (i.e. 2 x £325,000); Paul's nil-rate band and that of his second wife. The nil-rate band of Kitty cannot be used, as Paul's second wife's nil-rate band amounts to an *entire additional* nil-rate band.

If the nil-rate band of Kitty and Paul's second wife had been partially used up, then Paul's executors could have transferred both nil-rate bands to make up the value of one additional nil-rate band. However, if Paul had wholly or partially used up *his own* nil-rate band during his lifetime, his executors could not make up his nil-rate band to the full amount, even if there was an abundance of value available to transfer from the estates of Kitty and Paul's second wife which exceeded the value of a single transferable nil-rate band.

Example

If, when Kitty died, she had used up 75% of her nil-rate band, and Paul's second wife had used up 25% of her nil-rate band, Paul's executors would be entitled to claim the unused elements of both the nil-rate band of Kitty and of Paul's second wife to produce the value of one additional nil-rate band at Paul's death (75% + 25%.)

If Kitty had only used 50% of her nil-rate band, so that potentially there was 125% of the value of an additional nil-rate band available to transfer (Kitty's 50% + Paul's second wife's 75%) Paul's executors could still only claim the value of the one additional nil-rate band.

Conclusion

Although there may be more than one transferable nil-rate band, there can be no more than the value of one nil-rate band transferred. At times there may be less.

Inheritance Tax Made Simple

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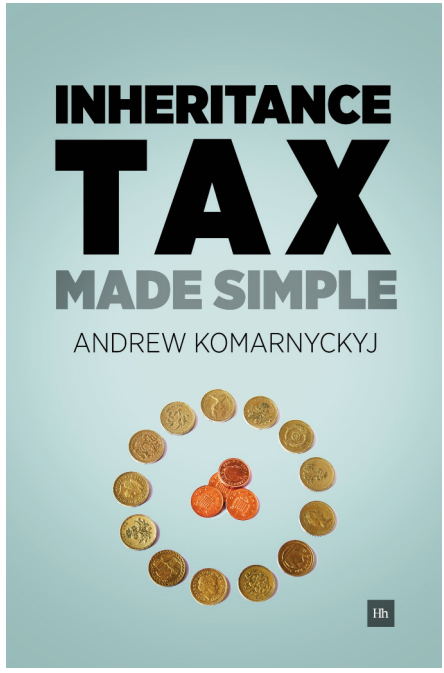
Andrew Komarnyckyj



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