Inheritance Tax

Anthony Nixon, Partner and legal expert at Irwin Mitchell outlines the changes for 2017.

Back in 2007, the Conservatives promised a £1 million Inheritance Tax allowance. In April 2017, this starts to take effect. It will only be £1million for married couples and civil partners; those who are single or divorced will be limited to £500,000.

It will be 2020 before the new tax giveaway reaches the million and it is hedged about with some complex conditions.

This will mean a rethink on forward financial planning for anyone concerned to minimise the impact of this most dreaded of taxes.

Inheritance Tax is currently 40% on estates over the basic tax-free allowance of £325,000. Married couples and civil partners can pass any unused allowance to each other after a death.

In 2017-18, the possible allowance rises to £425,000, then by £25,000 steps to reach £500,000 in 2020-21. A couple with a £1 million family home will then be able to pass it on free of tax. However, those with other valuable assets may not qualify. In calculating whether the new allowance, known as the 'Residence Nil Rate Band' (RNRB), can be added to the existing and automatic 'Nil Rate Band' (NRB), the whole estate is valued. If it is over £2 million, the RNRB is reduced by £1 for every £2 excess, so that estates worth more than £2.35 million get no RNRB.

For anyone needing to sell their property to 'downsize', but who might be deterred by potentially losing the new enhanced tax relief, special rules can preserve RNRB, but are highly complex.

The new regime will bring opportunities. The estate must include a home that the deceased has lived in, but this does not have to be the main 'family home' and if there is more than one property in the estate, a family can nominate one for the relief.

That home must be "closely inherited" - left to a direct or lineal descendant, which means family members and their spouses, and includes stepchildren, adopted or foster children, and grandchildren. Any RNRB that is not used, on a first death in a couple, can be transferred to a surviving spouse or civil partner.

Assets and property left in trust will qualify if the only beneficiaries are direct descendants who will have at least a life interest.

But there are pitfalls. Transferring an unused RNRB between spouses will not help if the survivor's estate becomes too valuable to qualify.

Couples who are not married to each other might think that each other's children would qualify, but they will not be "stepchildren" of each other and there will be no RNRB.

Nor do gifts between an unmarried couple themselves get the new relief.
The £2 million cut off is valued for RNRB purposes before deducting any business or agricultural property reliefs.

Anthony Nixon, Senior Inheritance Tax specialist at Irwin Mitchell, says that there are two significant elements to the new regime, one on the drafting of Wills, particularly in relation to trusts, the other in estate planning and the use of assets.

"For a husband and wife, there are the options of leaving outright or leaving in trust. It is about how the trust is worded when the second person dies. We want to encourage people to take stock of whether their Will meets todays' requirements. It is a big change and you have to jump through hoops to meet it."

Estate planning has also come back into focus with the £2 million limit on full entitlement for the RNRB.
"A lot of spouses will leave everything to each other and on the second estate it all bunches up and it could be over £2 million."

Anthony predicts a return to the NRB discretionary trusts, which were well used until 2007, as a way of not adding to the value of the survivor's estate.

The value of an estate can be reduced through either gifting or spending. However, Anthony warns that a giver must have full mental capacity – those with power of attorney cannot make gifts without an expensive court application. Anthony also comments: "The changes in taxation of pensions, and on death benefits payable from pensions, may mean it is worth spending down other capital and leaving pensions intact. Attractive as pension flexi-drawdown can be, it may be better to spend capital which you know would be taxed at 40% on death and which might also take you over the £2 million cut-off point for RNRB."

"Get advice on your Will. The lawyer should understand estate planning and the relevant tax issues and should be working with your other professional advisors to create a coherent strategy and give reassurance."

Irwin Mitchell has produced this article and kindly made it available to Spinal Injuries Association, to provide as a download from their website.

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