MACFARLANES

AN INTRODUCTION TO ESTATE PLANNING FOR MARRIED COUPLES

UK inheritance tax (IHT, at a headline rate of 40 per cent) can be a heavy burden on a family following a death. But if you are married or in a registered civil partnership with a same-sex partner, you can ensure that your family do not pay more tax than necessary, looked at globally after both deaths. All it takes is some straightforward, co-ordinated planning in your respective wills. This note assumes a standard textbook situation and gives a basic sketch of how some routine steps can save the family money. Separate notes take a more detailed look at the broader spectrum of IHT and the allied concept of "domicile", as well as the intestacy rules.

IHT ON DEATH – THE BASICS

The threshold at which IHT really starts to bite is low: £325,000 in the 2015/2016 tax year. It's sometimes called the "nil rate band", because up to that value IHT is charged at 0 per cent. The taxman can charge IHT at 40 per cent on everything you own above and beyond that value - your house, car, pictures, jewellery, a share of anything jointly-owned and so on. Trusts you benefit from may also be caught.

If you have made large gifts within seven years of death, they could also be added back into the pot to calculate the tax bill. There are a number of reliefs available, most prominently for some types of business and agricultural property.

However, gifts to your husband, wife or registered civil partner are not charged to IHT, if you are both UK-domiciled, both non-UK domiciled or the survivor is UK domiciled or elects to be treated as such for IHT purposes. This is known to tax planners as the 100 per cent spouse exemption. Whether or not you are UK-domiciled depends, broadly speaking, on the links you have to other countries (for example if you or your parents were born or have lived abroad). In this note, we assume that you are both UK-domiciled, but you should get professional advice on this point, as the rules are quite complex. (If you are UK-domiciled, but your spouse or civil partner is not, only £325,000 can be passed to them free of tax under the reduced spouse exemption unless your spouse elects to be treated as UK domiciled for IHT purposes.)

Any unused part of the nil rate band of a spouse or civil partner can be transferred to the surviving spouse or civil partner. On the first death a calculation needs to be made to work out if the estate of the first to die has used up all or any of their nil rate band. If the nil rate band is not used up the unused proportion is calculated: on the death of the second spouse or partner, that unused proportion is used to swell their own nil rate band. The nil rate band applicable on the second death is increased by the relevant proportion.

KEEPING IT SIMPLE

With the 100 per cent tax exemption and the transferability of the nil rate band the simplest way to mitigate inheritance tax is for both you and your spouse or civil partner just to leave all your property to each other in your wills.

OPTIONS FOR THE NEXT STEP

We have already noted that large gifts within seven years of your death can reduce the nil rate band available to your estate - and effectively increase the IHT to pay when you die, if they exceed the nil rate band allowance when they are added together.

The theory behind this is that, under the IHT laws, gifts to individuals made during your lifetime are potentially free of IHT. They are only charged to IHT if you die within seven years of the gift. And the longer you live after making the gift, the less tax there is to pay. If you die during the first three years after a gift, the full amount of tax attributable to the gift becomes due. The rate of tax is then decreased once you have survived three years from making the gift, and it continues to decrease year by year until you reach the seven-year mark and the gift is totally exempt.

The IHT system therefore favours those who make gifts and bet on surviving: the more assets you give away during your lifetime, the less tax there is to pay on your death, provided that you live at least three years from the date of the gift. Remember, however, that in order to make an effective lifetime gift you cannot continue to benefit from the asset - it is not, for example, effective for IHT purposes if you "give away" your house but go on living in it.

You can both make lifetime gifts in order to take advantage of this rule. It is also a good way to manage IHT planning after the first death; if the survivor finds that they have more money than they need to live on, they can pass it down to children and grandchildren. Provided that they survive seven years from the gift, that money will be passed on to the next generation completely free of IHT.

Of course, tax planning through lifetime gifts should never take priority over providing for your own needs, and you should never make any gifts unless you are completely comfortable that you are giving away surplus assets, retaining enough for you to maintain your own standard of living.

SAFEGUARDING THE FAMILY WEALTH

There are two main non-tax ways to safeguard wealth for your family by the terms of your will.

A life interest for the survivor

Some people prefer not to leave the rest of their estate to their surviving spouse outright, but instead give them a "life interest" in it. That means setting up in the will a basic trust arrangement, under which the survivor is entitled as long as they live to take the income from the estate and, for example, to live in a house or enjoy personal effects. However, unless the trustees of the trust (usually, at least at first, the executors of your will) allow them to, they cannot take the capital or change the people who will ultimately inherit it after their death, which is determined by the terms of the trust you have arranged in your will.

Delaying younger beneficiaries

Some people are anxious about leaving money to children and young people when they may not be old enough to use it wisely.

You can set up simple trusts in your will. This means that your trustees as executors would look after the money for the people you want to benefit. The terms of the trusts can be different. You could provide that, after your spouse or partner's death, your children are to inherit capital in equal shares but not until they reach a pre-determined age, say, 21 or 25. This does not mean that they cannot benefit at all before that age; your trustees would be able to use some of their money to pay for their housing, education, and so on. Following changes introduced in 2006, delaying outright gifts beyond 18 can have adverse tax consequences.

You can also give your trustees discretion in dealing with the trusts you have set up. This can be very useful, if something unexpected happens in the future. If one of your children suffered a serious illness and was unable to work, for example, your trustees could then give them more money from your estate for their support. It is possible to leave a confidential letter with your will to guide your trustees when they use their discretion - they are not bound to follow your wishes, but would usually at least take them into account.

PROVIDING FOR THE SURVIVOR

When the will is drafted so that the surviving spouse or civil partner takes a life interest in the remainder of the estate, a similar point applies. We could include a power in the will for the trustees to pass capital on to the survivor outright, which ensures that the trustees can see that they are properly provided for.

FOCUS POINTS

With all the possibilities for saving IHT, it is important to remain focused on your priority: to make proper provision for your surviving spouse or civil partner and the rest of your family when you have gone.

We can advise you on how this can best be done through your wills in a tax-efficient but flexible way to take account of all your family circumstances. We also have the expertise to guide you through other means of reducing the ultimate IHT bill - such as making lifetime gifts, or setting up trusts.

Married couples and registered civil partners have excellent opportunities to save IHT for their families, so thinking through your tax planning today is one of the best things you can do for your family's financial future.

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