

New IHT Rules – What You Need to Know

Chris Budd explains the changes to IHT and CGT announced in the pre-Budget report by Alistair Darling.

Now we have Mr Darling's response to the IHT debate. But what does this mean in practice?

Each individual is allowed to pass up to £300,000 on death free of inheritance tax (everything left to the spouse is tax free). This is known as the 'nil rate band'. Mr Darling has now allowed any part of the nil rate band not used on the first death, to be carried over to the second death. Although this is *not* a doubling of the nil rate band, it does effectively increase the band from £300,000 to £600,000 for couples and civil partners, with further increases to £700,000 by 2010. This will remove the IHT liability of many couples completely.

This is because many couples have not used both of these allowances. Under the most common type of will, all the assets of the first spouse to die pass to the survivor, meaning the total combined assets of the couple were ultimately taxable as the property of only the surviving spouse, and with the use of only one nil rate band.

In reality, this could often be avoided through will planning, typically by including a gift on the first death, perhaps into a trust. Mr Darling's announcement however means this exercise should no longer be required by most married couples, meaning a saving in legal fees at the very least. Indeed, where the major asset of an estate is a property (which cannot be split and passed on in two pieces), it will mean significant tax savings.

It also means that people can worry a lot less about inheritance tax, and concentrate on far more important matters, such as monitoring their investments, and this clearly has to be a good thing.

Under the new system, widows and widowers can claim their spouses' unused nil-rate allowances on top of their own. Not only that, but the change is retrospective, affecting the estate of any current widow or widower.

Any amount of the nil-rate band which is unused when the first partner dies can be claimed against the estate of the surviving partner, on their eventual death.

What should I do?

In essence the new regime is not that different from what went before. It simply removes a stage which was previously required in order to use both spouses' nil rate bands (i.e. the will planning and possibly use of trusts) to achieve the same end.

If you have an existing complex will in place for IHT reasons, there's unlikely to be anything to worry about. In anticipation of this, such wills can be rearranged within two years of the first death to get back to "square one" if this is preferred.

The main argument in favour of using the new legislation rather than will planning is the simplicity of this approach. A simple will leaving everything to the surviving spouse or civil partner may now be just as good as a more complex arrangement.

However, there may still be an argument for drawing up a will which uses the first £300,000 allowance when the first spouse dies. For example, this would protect against the increase in the value of the nil rate band not keeping pace with the value of a couple's assets in the future, as has been the case in the past, particular with regards to property. It would also give some protection against future changes in legislation.

As always, the starting point is to discuss your requirements in detail first and devise a plan to suit them.

Capital Gains Tax changes

The changes to capital gains tax (CGT) are rather more far reaching.

The two main types of relief available when disposing of an asset, Taper Relief (introduced in 1998 by then Chancellor Gordon Brown), and Indexation Relief, designed to give some protection against being taxed on the effects on inflation on the value of an asset, are both being scrapped. Instead a single rate of CGT, of 18%, will be introduced.

The main objectives of this appear to be to simplify the system, and to increase the taxes paid by private equity bosses. They receive among the most favourable tax treatment under the current system as their disposals are business assets, which receive a much more generous degree and rate of Taper Relief.

However, it will also affect the small business owner, who will see an effective increase in tax from 10% to 18%.

The main beneficiaries of the change will be private investors, particularly if they are higher rate tax payers. Such investors into the stockmarket and property will see a reduction from a potential 40% tax charge to 18%, a significant reduction.

What should I do?

If you plan to make disposals, it would be certainly wise to discuss whether it would be advantageous to do so before – or after – the new regime becomes effective, from 6th April 2008. For example, a buy to let property, owned for more than 10 years, could be sold by a basic rate tax payer with at a current tax rate of 12%, which will increase to 18% after April 5th.

On the other hand, a higher rate tax payer, holding a share for less than 2 years, could pay 40% tax on a disposal, which will reduce to 18% if they wait until the new tax year.

The investment bond, as operated by life assurance companies, may well be redundant, however, in favour of unit trusts and other such vehicles. Whether existing bonds should be encashed and reinvested is a question which will be largely guided by individual circumstances, however.

This article is for general information only and you should seek professional advice in respect of your own circumstances. Please note the value of investments and income from them can fall as well as rise. You may not get back the full amount invested.

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This article appeared in the Mature Times, November 2007 edition – visit their website at www.maturetimes.co.uk

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