

Nil Rate Band Discretionary Will Trusts After The Finance Act 2008

The Finance Act 2008 received Royal Assent on 21st July 2008 thereby making law the provisions for transferable nil rate bands for married couples and civil partners in relation to Inheritance Tax (IHT) on death. This information sheet is designed to provide information on the new system and to explain the potential advantages of retaining a Nil Rate Band Discretionary Trust in your Will.

Inheritance Tax Pre Finance Act 2008

Every individual has a nil rate band allowance which is applied to their estate on death. The nil rate band as from 6th April 2009 is £325,000. For IHT purposes, the first £325,000 is taxed at 0% and the remainder over and above £325,000 is taxed at 40%.

It is quite usual for spouses and civil partners to leave everything to each other. No IHT is payable on the first death as the transfer to the survivor qualifies for spouse/civil partner exemption. The survivor's estate, which will then comprise the entire joint estate, will be liable for IHT but until last year only one nil rate band of £325,000 was available on the death of the survivor. This meant that the nil rate band of the first spouse or civil partner to die was not utilised.

In order to ensure that the nil rate band of the first spouse or civil partner to die was utilised, couples were usually advised to ensure use of the nil rate band in their Wills, often involving a Nil Rate Band Discretionary Trust. This meant that rather than the whole estate passing to the survivor, the Nil Rate Band amount was directed into a discretionary trust. This ensured that both Nil Rate Bands were fully utilised and there was no waste of tax relief.

Inheritance Tax Post Finance Act 2008

The Finance Act 2008 has introduced the concept of the transferable nil rate band for where the surviving spouse or civil partner dies after 9th October 2007. Now, where one spouse or civil partner dies without utilising all of their Nil Rate Band, a claim can be made on the death of the surviving spouse or civil partner to transfer any unused Nil Rate Band. For example if the first spouse/civil partner to die leaves everything to their surviving spouse/civil partner, they will not have used any of their Nil Rate Band and so the surviving spouse's/civil partner's Nil Rate Band will be uplifted by 100% on their death. At the current tax rates it would mean a Nil Rate Band of £650,000 would be applied to the survivor's estate.

It should be noted that it is the proportion of the unused tax exemption that is carried forward, not the actual amount of the unused tax free band. That means the uplift on the death of the survivor is calculated at the rates that apply at that time.

Do Existing Wills Need To Be Altered?

There is no need to change an existing Will which contains a Nil Rate Discretionary Trust simply because of the legislative changes. One advantage of a Nil Rate Discretionary Trust is that if, upon the death of the first spouse or civil partner, it is apparent that the Trust is not going to serve a useful function, then the trustees can simply opt to pay out the trust fund to the survivor. If the assets of the trust are transferred out of the Trust to the survivor within two years of the date of death, for tax purposes it is treated as if the assets had been left outright to the survivor under the Will. If this is successfully completed then a claim to transfer the nil rate band can be made upon the death of the survivor.

It would be advisable to review Wills that leave gifts of the Nil Rate Sum to non-exempt beneficiaries such as children.

Is a Nil Rate Discretionary Trust Needed?

Nil Rate Discretionary Trusts set up for IHT planning reasons may not be required any longer. Many may feel more comfortable with a simple Will leaving everything to each other.

There are a number of options available where a Will contains Nil Rate Discretionary Trust provisions that are no longer required:

- Execute a codicil removing the clause containing the Nil Rate Discretionary Trust provisions;
- Execute a new Will excluding the Nil Rate Discretionary Trust;
- Leave the Will as it is and wait until at least three months but no more than 2 years has elapsed from the date of death of the first spouse or civil partner and appoint all the assets to the survivor, thereby terminating the Trust and relying on the new IHT transferable nil rate band legislation.

There may be advantages to retaining the Nil Rate Discretionary Trust provisions. The Trust can ring fence assets up to the value of the Nil Rate Band which may be useful in certain circumstances:

- Providing for children from a previous relationship or other family members;
- Providing for disabled beneficiaries without affecting any benefits they may receive;
- Protecting assets where beneficiaries are in the process of getting divorced or becoming bankrupt;
- Safeguarding further IHT liabilities in beneficiaries' estates;
- Protecting assets where the surviving spouse or civil partner has long-term care provisions on a means tested basis;
- Protecting assets for future generations in the event of remarriage of the surviving spouse or formation of a new civil partnership of the surviving civil partner.

If asset protection is a concern, then it may be worth considering a simple life interest in favour of the surviving spouse. This qualifies for spouse/civil partner exemption on the first death and the transferable nil rate band on the second death, whilst ring fencing some of the assets of the estate against, for example, care fees or claims arising from a subsequent marriage.

In order to claim the transferable tax allowance, certain evidence is required by the Inland Revenue. Information about the estate of the first spouse or civil partner to die would need to be provided to the Revenue within two years of the death of the surviving spouse or civil partner. This may be distressing for families at a difficult time. Sometimes the information is simply not available. Where there is a Nil Rate Band Discretionary Trust, there is no such requirement. The tax exemption has already been "banked".

If there is insufficient evidence available to prove to the Inland Revenue that the first spouse or civil partner had unused Nil Rate Band relief, then the Inland Revenue could refuse the claim.

Contact:

Godalming
Church House
30 Church Street
Godalming
Surrey GU7 1EP
☎ 01483 417121

Guildford
55 Quarry Street
Guildford
Surrey GU1 3UE
☎ 01483 543200

Woking
Concord House
165 Church Street East
Woking
Surrey GU21 6HJ
☎ 01483 748500