



Private Client Law Bulletin

THE TRANSFERABLE NIL-RATE BAND AND MARRIED COUPLES - the Second Spouse Trap

In the Pre-Budget Report of 9 October 2007, it became possible for spouses and civil partners to transfer their nil-rate band allowances for Inheritance Tax (currently £300,000) so that any part of the nil-rate band that was not used when the first spouse or civil partner died can be transferred to the individual's surviving spouse or civil partner for use on his/her death.

The guidelines issued with the Report stressed though that if someone has survived more than one spouse or civil partner then the claim is to be limited to one additional nil-rate band.

However, making use of an allowance in that situation can create planning opportunities but also complications that need careful consideration (and knowledge of a client's personal history).

Suppose a client (Mrs B) has a standard will creating a nil-rate band discretionary trust with the residue passing to her husband (Mr B). Caught up in the excitement of the Pre-Budget Statement, Mrs B changes her will leaving all to her husband. She is pleased to be rid of the complicated trust and her husband will be now able to use her allowance anyway if she dies first and as a couple that would mean that they have each made full use of their £300,000 allowance.

However, Mrs B has been married before – to Mr A. She was widowed and then married Mr B later on in life. Mrs B is a private lady. She had not mentioned her earlier marriage to her solicitor at the time her will was drafted and there was no need for anyone to pry into this at the time. Unbeknownst to Mrs B, she now (post 9/10/2007) already has a spare nil rate band allowance, of Mr A, to use which she inherited from him. She could make use of that in her will and Mr B's executors could still claim a "double" nil rate band" (his own and Mrs B's). A £600,000 allowance for the couple could be £900,000 if the wills are drafted correctly.

So in that situation, a couple may still want to use a standard nil rate band discretionary trust, right? Well, not quite. If Mrs B leaves her will as it is and the will is worded in a standard way – "I leave as much as I can without paying tax to a discretionary trust" then £600,000 would actually pass into this trust if she dies first. This is probably more than Mr & Mrs B intend. It also creates tax problems as exit charges will arise in the future when money is withdrawn from the trust as such a charge is calculated by reference to a single nil rate band.

Mrs B's will could be worded to achieve the optimum result - £300,000 into a discretionary trust on first death, and with her husband still having the right to use a £600,000 allowance on his death. It is unlikely to arise in default though and will need to be arranged with properly drafted documentation.

The conclusion? Mrs B needs to review her will urgently.

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