

Inheritance Tax – Nil Rate Band Discretionary Trusts



Inheritance Tax (IHT) is currently charged at 40% on the total value of all assets on death so far as the total exceeds £325,000 (the Nil Rate Band). Anything left to a surviving spouse or civil partner (provided that they are both domiciled in England and Wales) passes tax free. References in this note to married couples and spouses should be read as including civil partners.

As of October 2007, married couples are able to “transfer” any unused Nil Rate Band on first death to the survivor, potentially increasing his/her tax free allowance (if the first to die leaves everything to the other and has not made lifetime gifts in the 7 years prior to death) to £650,000.

Prior to October 2007, it was sound advice to include a trust in Wills drafted for married couples to ensure that the Nil Rate Band allowance of the first to die was not lost. Now that the allowance can be transferred, it is no longer necessary to include this trust in the Wills just to gain the IHT advantage. However, there are still reasons why married couples may like to consider retaining such trusts, as part of their overall tax and succession planning strategy:

Changes in Legislation – It may be desirable to ‘bank’ one Nil Rate Band allowance on first death and make that amount of money available to the surviving spouse and other beneficiaries via the trust. The Nil Rate Band is a political instrument and therefore subject to change and there is no guarantee that it will always be possible to transfer it. It should not be assumed that in the years to come the Nil Rate Band cannot be frozen, reduced or even abolished.

Protection of Assets - The assets passing into this trust do not form part of the surviving spouse’s estate (although he/she could access them if necessary). A trust can protect the assets, for example:

- From creditors of the surviving spouse
- On re-marriage of the surviving spouse
- If the survivor is assessed by the Local Authority for self-funding of care fees
- If the survivor should lose mental or physical capacity to manage their money and become vulnerable to financial abuse.

Capital Appreciation - The Nil Rate Band allowance is set to remain at £325,000 until at least April 2015. The capital appreciation of the assets in the Nil Rate Band trust may be predicted to outstrip future increases in the Nil Rate Band allowance and the growth on the assets within the trust would be outside of the joint estate on second death.

Several Nil Rate Band Allowances – Only one additional unused Nil Rate Band allowance can be carried forward to be used on the second death, so that each person can claim a maximum of a double allowance (regardless of the number of marriages!). However, it is possible for a couple to benefit from a maximum of **four** allowances between them, if they have both been widowed previously and careful planning is carried out in both of their Wills. This is because each of them can claim the unused allowance of their pre-deceased spouse, as well as their own, on their death.

Care should be taken to ensure that this potential tax saving is used, while still giving effect to the overall wishes as regards the distribution of assets between various beneficiaries via the Wills.

The disadvantage of using the Nil Rate Band trust is the administration involved (including the tax compliance) and the slight loss of autonomy as the surviving spouse does not have complete control over this 'pot' of money.

The main advantage of the trust is the flexibility that it affords to take account of the circumstances following first death. It is possible to wind up the trust and transfer the assets to the surviving spouse (or the other beneficiaries), although this could only happen with the agreement of all of the trustees. If the assets are transferred out of the trust within two years of the death, then the administration and tax compliance involved with the trust may be avoided.

If you require any specific advice in connection with the material contained in this bulletin, or on any other Private Client issues, please contact: Duncan Bailey in Liverpool on 0151 600 3451, Richard Bate in Manchester on 0161 836 8840 or Stephen Marriott in Preston on 01772 229816.

If you wish to receive the bulletin please let us know by contacting Liz.Fox@brabnerscs.com

This bulletin is for general guidance purposes only and should not be used for any other purpose
Brabners Chaffe Street is a Limited Liability Partnership

**LIVERPOOL**

Horton House, Exchange Flags, Liverpool, L2 3YL
0151 600 3000

MANCHESTER

55 King Street, Manchester M2 4LQ
0161 836 8800

PRESTON

7-8 Chapel Street, Preston PR1 8AN
01772 823921