

nil rate band discretionary trust wills – are they still needed?

new inheritance tax provisions

The Pre-Budget Statement made on 9 October 2007 has made significant changes to Inheritance Tax. Although the new provisions have been slightly misconstrued by the press who have indicated that the nil rate band allowance has "doubled", it is correct that married couples or couples in civil partnerships, can now benefit from both parties' tax-free allowance (which is currently £312,000 from 5 April 2008) in addition to their existing entitlement to full spouse relief. Prior to this date, the only way of achieving this would be to have a nil rate band discretionary trust Will. Do they still have any use?

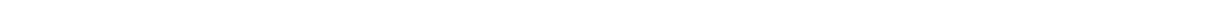
advantages of the nil rate band will post-9 october 2007

There are advantages in keeping the nil rate band trust in your Will. For instance, the assets placed in the trust are not owned by the survivor outright but are assets belonging to the trust and, consequently, those assets are not accessible to fund care fees. As care fees are a growing concern, culminating in many people having to sell their house to fund such fees, this is an increasingly important factor to consider. Equally, the placement of assets into trust gives some protection against other concerns. If assets are left to the survivor outright he/she could spend all the money, give it away to others, have it taken away by creditors or by new spouse and so on, meaning that the intended original beneficiaries (named in the will of the first person to die) could lose out.

Moreover, should you choose to make up the nil rate band by investments such as shares or property, these investments may rise in value much quicker than the nil rate allowance each year. For illustrative purposes, from the tax year 2006/2007 to 2007/2008 the allowance increased by £12,000. If you held £300,000 worth of investments during this period it is quite possible that you would have an increase in value over and above the increase in the nil rate band allowance.

disadvantages of the nil rate band post-9 october 2007

One of the disadvantages of the nil rate band discretionary trust is the time, effort and cost of running the trust set up on the first death under the terms of the Will, which the survivor, being a trustee, may feel is not worthwhile without the tax saving. In any event, another disadvantage is that the surviving spouse does not have absolute discretion over the assets as all decisions must be agreed by all the trustees.



going back to basics

There is now benefit to keeping your Will simple. If you leave your estate simply to the surviving spouse then the nil rate band would pass to the survivor of you on first death, and then on second death you would be able to pass two full nil rate bands at whatever the allowance is at the date of death of the second to die. For instance, under your present Wills if one of you died in this tax year the nil rate band would be £312,000 and assets to this value would pass into trust. If the second of you to die then died in the tax year where the relief is £350,000, as you have already used up 100% of the allowance of the first to die in the trust mechanism the only further allowance will be the survivor's £350,000. By contrast, under the new regime, if the first of you to die died this year without leaving money into trust, 100% of this allowance would automatically pass to the survivor for use on second death. Then if the survivor died in the tax year where the nil rate band was £350,000 they would not only have their own £350,000 to use but in addition to this would have 100% of the predecessor's allowance, giving them a total tax-free allowance of £700,000. Clearly, this potentially means that by doing the nil rate band as opposed to a simple will leaving everything to each other, you will have missed the opportunity of this transfer of allowance and, in this scenario, an additional £38,000 inheritance tax-free allowance.

summary

Many people have already elected to change their discretionary trust Wills in order to simplify the estate of the first to die. The trust mechanism is complex and many feel that the time and costs involved in administering a trust are disproportionate to the advantages listed above, especially since there is the potential risk that you could forgo a big tax saving if there is a great lapse in time between the first and second death. However, there are concerns that if assets are left to the survivor outright then they could be less protected in overall terms.

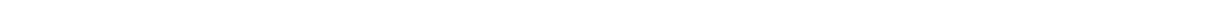
beware!

One factor which is becoming apparent is that if couples elect to rely on this spousal transfer of the nil rate band, upon first death there is a much greater onus on documenting the winding up the estate so as to safeguard the success of using that second allowance on second death. Upon second death the executors of the second to die must elect to use this second allowance (it is not automatic), which in itself will increase paperwork, and consequently legal fees in winding up the second estate.

solution?

One solution giving the greatest flexibility is to keep the discretionary trust Wills in place. The Trustees then have two years from the first death to decide whether the circumstances at that time warrant keeping the trust in place. If they do not feel that the trust is desirable they can wind it up without any adverse Inheritance Tax implications.

Wills should always be kept under review, particularly if there have been any changes in circumstances since they were concluded.





get in touch

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