

WILLS AND THE IHT NIL RATE BAND THE CHANCELLOR'S PRE BUDGET REPORT

1 BACKGROUND

1.1 In his pre Budget Report on the 9th October 2007, the Chancellor announced a change in the availability of the nil rate band.

1.2 The present nil rate band is £312,000 and this is the amount which can be given free of inheritance tax.

1.3 Previously, if the nil rate band was not used on the first death of a married couple or civil partners, it was wasted. So, many married couples and civil partners have ensured that on the first to die, rather than leaving the whole of their estate to the survivor, an amount from their estate up to the nil rate band is gifted by Will elsewhere. This course of action saved £124,800 in inheritance tax.

1.4 In practice, the nil rate band on the first death is often left by Will to a discretionary trust for the benefit of the survivor, children and other relatives. Sometimes the nil rate band is left by Will directly down to children, and sometimes to a trust specifically for the children and no one else.

2 THE PROPOSALS

2.1 It is proposed that where the nil rate band is not used on the first death, that proportion of it which is unused can be carried forward and be available on the second death.

2.2 It is not the actual nil rate band on the first death that is carried forward, but the unused percentage which is then applied on the second death using the nil rate band at the second death. So, although the nil rate band is currently £312,000, if this is unused on the first death (i.e. 100% unused), and the nil rate band on the second death has increased to £400,000, the actual amount of nil rate band available on the second death is increased to £800,000.

2.3 The proposals apply where the second death occurs on or after 9th October 2007, even where the first death has already occurred. This means that where one spouse or civil partner has died before 9th October 2007 without having used the nil rate band in whole or in part, a greater nil rate band will be available on the second death.

3 SHOULD THE NIL RATE BAND BE USED AT ALL ON THE FIRST DEATH?

3.1 Since the nil rate band of the first spouse/civil partner to die will be available in any event on the second death, is there any reason why it should be used at all on the first death?

3.2 This depends on a number of factors including the nature of assets in the estate of the first to die, an assumption as to investment returns and a prediction as to whether the nil rate band will have increased by the time of the second death.

3.3 In many cases, the major asset in the estate of a married couple or civil partners is the family home. The nil rate band in such cases is often used on the first death by passing the nil rate band into a discretionary trust and the trust being satisfied by an IOU rather than a share of the house. There may be little point in using the nil rate band in this way in the future. The amount of the IOU is normally a fixed amount on the first death, and will not increase in value. In this case, if the nil rate band increases by the time of the second death, greater tax savings would have been achieved had the arrangement not been set up.

3.4 In other cases where the nil rate band can be satisfied out of cash, stocks and shares or other investments, an IOU would not necessarily be needed. In this case using up the nil rate band on the first death could be beneficial if assets given away on the first death grow in value at a faster rate than the rise in the value of the nil rate band.

3.5 There may of course be other personal reasons why individuals may wish to gift part of their estate on the first death to children or other relatives, rather than awaiting the second death.

4 DO I NEED TO CHANGE MY WILL?

4.1 Where a Will of the first to die includes a nil rate band discretionary trust of which the surviving spouse/civil partner is a beneficiary, no specific changes to the Will are required on account of the Budget proposals. Following the first death, a decision can be made as to whether the trust is established or not. It should be possible for this trust to be wound down within 2 years of the first death by transferring its entire assets to the surviving spouse or civil partner, thereby negating the trust and negating the use of the nil rate band. This point is confirmed by HMRC in their Press Release issued on 9th October 2007.

4.2 Where the Will of the first to die includes a legacy of the nil rate band to individuals (for example adult children) a decision as to whether this is implemented or not following the first death rests with the children. It would be possible for them to disclaim their legacy within 2 years of the first death or carry out a deed of variation within 2 years of the first death by redirecting it to the surviving spouse or civil partner, thereby negating the use of the nil rate band. Nevertheless, the position here may need to be reviewed.

4.3 Where the Will of the first to die includes a legacy to any other type of trust, it would not generally be possible to negate this legacy by appointing assets within 2 years to the surviving spouse or civil partner or by deed of variation. The position here should be reviewed.

4.4 We would normally advise individuals to review their Wills in any event every five years or earlier if circumstances change.

5 DO I NEED A NIL RATE BAND DISCRETIONARY TRUST?

5.1 As mentioned in 4.1 above no change is required to a Will which includes a nil rate band discretionary trust. A decision can be made as to whether this trust is actually implemented following the first death.

5.2 Our current view is that it may not be worth implementing a nil rate band discretionary trust where the trust is to be established with an IOU given by the surviving spouse or surviving spouses' trust.

5.3 However, where the discretionary trust can be funded with other assets it still may be worthwhile to establish this trust:

5.3.1 If the assets in the trust grow in value at a rate greater than the rise in the nil rate band a greater inheritance tax saving will be achieved through use of the trust.

5.3.2 Within a discretionary trust, income can be distributed to a wide variety of beneficiaries who would pay income tax at their own marginal rates on the income received, which in the case of children/grandchildren could be much lower than the income payable by the surviving spouse on these assets had the trust not been established.

5.3.3 The trust has an additional capital gains tax allowance.

5.3.4 Discretionary trusts are very flexible and provide a degree of asset protection.

Legislation is intended to be introduced in the Finance Bill 2008 and draft legislation has already been produced. For further information please contact Nick Acomb, John Murray, Daryl Fox or your usual contact at the firm.

This information is necessarily brief and is not intended to be an exhaustive statement of the law. It is essential that professional advice is sought before any decision is taken.

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