



## Nil Rate Band Discretionary Trusts

Prior to the pre-budget speech of October 2007 it was generally recommended that, where married couples or those in civil partnerships had total estates in excess of the nil rate band (£325,000 for the 2012/2013 tax year), they fully utilised their nil rate bands by the use of tax efficient Wills. These may have included nil rate band discretionary trusts which allowed the surviving spouse to benefit from the assets, if required, with those assets not required passing eventually to other members of the family.

This arrangement ensured that both parties to the marriage or civil partnership utilised their nil rate bands as otherwise, if traditional Wills had been prepared whereby total assets were left to the survivor, only one nil rate band would have been utilised on the death of the survivor. This is because assets passing on the first death would have been exempt under the surviving spouse or civil partner exemption.

### **New Provisions**

Under the Chancellor's pre-budget speech in October 2007, as confirmed by the budget in March 2008, the proportion of any inheritance tax nil rate band unused on a person's death can now be transferred to the estate of their spouse or civil partner, if that spouse or civil partner dies on or after the 9<sup>th</sup> October 2007. This therefore means that if, for example, traditional Wills are executed by a married couple leaving everything to each other and then to the children both nil rate bands can now be utilised, without the need for a nil rate band discretionary trust. The initial conclusion from this is that nil rate band discretionary trusts are no longer of any use but there are a number of circumstances where in fact a nil rate band discretionary trust (NRBDT) could be of benefit as outlined below:-

### **Increase in Value of Assets**

If it is considered that assets could increase in value in excess of the future increases in the nil rate band the use of a NRBDT would be beneficial as it could still reduce the inheritance tax payable on the death of the surviving spouse or civil partner.

### **Children Wealthier than Parents**

In general terms every generation is wealthier than the previous generation and it is possible that your children will have assets in excess of the nil rate band. Therefore Wills incorporating the NRBDT can benefit children as on the death of the survivor the funds held in the NRBDT will be available to the children for whatever purpose they require but would not form part of their estate for inheritance tax purposes on their death. In fact a similar trust arrangement can be created on the death of the surviving spouse which will enable children and grandchildren etc. to access funds without these forming part of their estate for inheritance tax purposes.

### **Widow(er) Remarries**

Under the Chancellor's provisions for the transferability of the nil rate band, the unused allowance of any number of former spouses or civil partners can be utilised up to the maximum of one whole nil rate band. Therefore if a widow or widower remarries they could take advantage of the transferability of the nil rate band from both their first and future spouses up to a maximum amount of the nil rate band. Therefore if the estates of both deceased spouses were in excess of the nil rate band in total, some of the benefits of the enhanced nil rate band, would be completely lost. However this could be avoided by the use of nil rate band discretionary trusts to ensure full usage of the allowance on each death.

Whilst, when arranging a Will, you may not be considering the possibility of remarriage on the death of your spouse, the provision of a nil rate band discretionary trust could have substantial benefits to your family; as if your spouse were to remarry they could then benefit from the transferable nil rate band of their new wife or husband. In fact if a wealthy widow married a wealthy widower up to four nil rate bands could be utilised providing a substantial saving in inheritance tax.



## Long-term Care

Assets held in an NRBBDT might not be taken into account in determining whether the surviving spouse qualified for local authority funding towards care costs. Therefore the surviving spouse may be able to claim support towards care costs from the local authority whilst still having access to the trust funds.

The above provisions also apply to civil partnerships.

## Disadvantages of Nil Rate Band Discretionary Trusts

Set out over are the advantages of this type of arrangement but there are of course a number of disadvantages as follows:-

### Complexity and Cost

Transferring a nil rate band from a previously deceased spouse to a surviving spouse's estate is relatively straightforward providing that all the information is available. On the other hand setting up a NRBBDT and managing the trust can result in additional expense and complexity although the potential advantages could far outweigh the additional costs and complications.

### Taxation Implications

Assets held in an NRBBDT are subject to income tax at the rate applicable to trusts, which for interest and rental income is 45% as of 6<sup>th</sup> April 2013. This could compare with the surviving spouse's tax rate of 20%. However by the judicious usage of certain assets or by releasing income to non or lower tax paying beneficiaries the higher rate tax liability payable in trust can be mitigated or reduced completely.

### Inheritance Tax

NRBBDT's have their own nil rate band allowance and are subject to an inheritance tax calculation on releases and every ten years. However the tax liability can be reduced completely by ensuring that the value of the trust remains below the nil rate band in place at the time.

### Lifetime Nil Rate Band Trusts

In the event that you have assets to invest now and are confident that you will not need access to these funds in the future you could arrange for these assets to be transferred into a nil rate band discretionary trust created during your lifetime rather than via your Will on death.

The advantage of this is that if you survive seven years from creating the trust it would not be added to.

your estate for the purposes of calculating the inheritance tax on your death.

This would then allow you to create a further discretionary trust after seven years, again without any immediate liability to inheritance tax. In addition any growth in the trust assets would be outside of your estate for the purposes of calculating inheritance tax.

Alternatively if you need to derive an income from the investment or would want to have access to your capital a discounted gift trust or loan trust may be more appropriate.

### Existing Wills

If you have already made a will which incorporates a Nil Rate Band Discretionary Trust it is not necessary to revise your Will, even if you would prefer that the trust is not implemented. The reason for this is that the trustees may after 3 months and before two years of the death of the first to die release the trust assets to the surviving spouse. This would then be treated as though the Nil Rate Band Discretionary Trust did not exist allowing the Nil Rate Band to be transferred to the surviving spouse. Additionally of course there is always the possibility that the current provisions allowing the Nil Rate Band to be transferred might be rescinded in the future. Alternatively, if you would prefer, new Wills can be drafted removing the Nil Rate Band Discretionary Trust but this would involve additional costs.

### Contact Details

If you would like any further advice on Nil Rate Band Discretionary Trusts please do not hesitate to contact us.

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