



The Nil Rate Band Trust

Since October 2007 couples have been allowed to transfer their inheritance tax-free allowance to their surviving spouse/civil partner. This allowance is also known as the Nil Rate Band (or NRB) and currently stands at £325,000 – it has been frozen at this value since 2009 and won't increase until 2021 at the earliest. This means that as long as you don't use the allowance by or on first death, the tax-free portion of the estate's value doubles to £650,000 on the death of the second partner.

However, if you are in a relationship but either not married or not in a Civil Partnership, then you can't use your partner's allowance. This means that while you may benefit from inheriting his/her estate, your children (or other secondary beneficiaries) will be liable for a far bigger slice of Inheritance Tax when you die as your estate will be that much bigger.

Setting up a Nil Rate Band Discretionary Trust (NRBDT) can help couples who don't qualify for the full Inheritance Tax benefits open to people who are both married and domiciled in this country. This is done by ring fencing the tax-free allowance of the first to die from being taxed on second death. It can be used to protect part or all of your estate, up to the value of your individual NRB.

This can also help married couples or civil partners where one is UK domiciled and the other is not. If the domiciled partner dies first, then the amount that can pass to the survivor is the NRB plus a foreign spouse lifetime allowance (that tracks the value of the NRB), so potentially double the value of the NRB. Everything else is subject to tax at 40%, so the Nil Rate Band Trust can help here too.

From April 2017 a new tax free allowance on the home (the Residential Nil Rate Band or RNRB) has been introduced which has several qualifying rules. One such rule is that the allowance reduces by £1 for every £2 that your estate value exceeds £2M. By the 2020/21 tax year the RNRB, which is transferable between spouses, will be £175,000. Under the rules if the value of a couple's estate is over £2.7M then the RNRB would be lost totally. By introducing a NRBDT into the Will of the first to die might be advantageous if it were to keep the estate value on second death below the £2.7M threshold.

What are the tax savings?

For non-married or mixed domicile couples, taking steps to allow the use of both Nil Rate Bands creates a potential saving in Inheritance Tax of £130,000.

For married couples with an estate over £2.7M (in 2020/21), using the NRBDT in the Will of the first to die could create a saving of Inheritance Tax of £140,000.

Option to opt out

The trust gives powers to the trustees which enables them to decide not to create the trust on 1st or 2nd death, if it is deemed less beneficial to the estate or the surviving partner.

A CASE HISTORY

Paul and Emma have no plans to marry. They have a joint property worth £450,000 with no mortgage and various joint accounts giving a total estate value of £650,000. In their Wills, they have left everything to each other and then their three children. Paul dies first and, as his share of the estate is below the Nil Rate Band, there is no tax to pay on his death. However, their children will miss out when Emma dies as the estate will be liable for Inheritance Tax of £130,000.

The Solution

They should re-draft their Wills to include a NRBDT which will protect the NRB of whoever dies first. They should also change the way their property is owned so that they are tenants-in-common and ensure that equal portions of the estate are held in their own names.

On Paul's death the NRBDT is established. So that Emma doesn't lose use of any of the estate/assets, she issues an IOU to the trustees to the value of Paul's NRB. This loan is then recalled to the trust by the Trustees on Emma's subsequent death which can then be used for the benefit of or loaned to their children.

Tax on Emma's death - Without the NRBDT

| | |
|-----------------------------------|------------|
| Inheritance Tax on Paul's death: | £0 |
| Inheritance Tax on Emma's death: | |
| Gross Estate | £650,000 |
| Minus the tax-free allowance | - £325,000 |
| Net Estate for calculation of IHT | £325,000 |
| Inheritance Tax @40% | £130,000 |

Children's Inheritance

| | |
|-----------------------|------------|
| The Estate | £650,000 |
| Minus Inheritance Tax | - £130,000 |

Total Children's Inheritance **£520,000**

Tax on Emma's death - With the NRBDT

| | |
|-----------------------------------|------------|
| Inheritance Tax on Paul's death: | £0 |
| Inheritance Tax on Emma's death: | |
| Gross Estate | £650,000 |
| Minus loan due back to Trust | - £325,000 |
| Minus the tax-free allowance | - £325,000 |
| Net Estate for calculation of IHT | £0 |
| Inheritance Tax @40% | £0 |

Children's Inheritance

| | |
|-----------------------------|-----------|
| The Estate | £325,000 |
| Minus Inheritance Tax | - £0 |
| Plus the funds in the NRBDT | +£325,000 |

Total Children's Inheritance **£650,000**

It is clear from this illustration (which intentionally excludes any calculations involving the Residential Nil Rate Band) that a NRBDT can ensure that substantial sums of money (in this case £130,000) are passed onto your chosen beneficiaries and not the tax man.



How does it affect me today?

Whilst you are both still alive none of your assets or home will be affected. The trust is only set up on death. Until then you can continue to benefit fully from your estate.

Other things you may wish to consider

Depending on how your estate is structured, equalising the assets held by you and your partner may be necessary to maximize the use of the Nil Rate Band Trust so that both partners have sufficient assets in their own name. This may include changing tenancy on the home from joint tenants to tenants in common.

Are there other benefits?

Even if the circumstances described overleaf do not apply to you, by drafting Wills that incorporate the Nil Rate Band Discretionary Trust, you and your partner can ring-fence your NRB on 1st death or even on 2nd death, if required.

As circumstances change, it is best to have the most flexible Will possible leaving all options open. In this way the final decision on saving tax, succession planning and wealth protection can be taken after first death. If, taking into account the circumstances at such time, it is deemed detrimental for the NRB to run, then the trustees have up to 2 years to decide to appoint all trust funds to the survivor, with the same tax impact as if there had been no Trust.

Some of the situations where it will still be desirable to use the NRB on first death include:

- **Indexed IOU** - Historically the "growth" or index-linking of the IOU has outpaced the increase in the value of the NRB. You may feel that this will continue to be the case and want to implement the indexed IOU to increase the tax savings (as the growth of the IOU will be held in trust and, therefore, outside of the taxable estate of the survivor).
- **High Growth Assets** - Some assets (such as your property) are likely to grow in value to be worth more than the anticipated rise in the NRB; this might include shares in a business or high-performing investment funds. If no use is made of the NRB on first death, investment growth will remain in the estate of the survivor.
- **Remarriage after first death** - Only one NRB can be carried forward to second death, regardless of the number of times that you have been widowed. However, if a NRB is implemented on the death of each spouse then an additional tax saving of £130,000 can be secured per spouse.
- **Family Heirloom** - You may view the NRB as a family heirloom, to be passed down to benefit future generations. It can benefit the family without being in their estate for inheritance tax purposes.

- **Divorce or Remarriage & Step-children** - If you remarry, whether after a divorce or widowhood, and then be the first to die out of the new marriage, all of your estate could pass to your second spouse and then consequently onto their beneficiaries, e.g. your step-children, leaving your own children with nothing. Setting up the NRB on your death enables you to preserve the NRB for your own children.
- **Long Term Care Costs** - Having an IOU or charge on your property can prevent assets (up to the value of the NRB) being taken into consideration should the survivor need to be assessed for long term care fees.
- **Generation Skipping** - Having a NRB set up where the beneficiaries are the spouse, children and descendants means that, at the discretion of the trustees, funds can be distributed to grandchildren without aggravating the IHT position of your children (or impacting on any benefits they may receive).

