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EXPLANATORY NOTES

THE TRANSFERABLE NIL RATE BAND ALLOWANCE

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In 2008 the so-called "Transferable Allowance" was introduced, which provided extremely advantageous allowances from Inheritance Tax (IHT) for married couples and civil partners, and also for families where a spouse or civil partner may have already died.

The Transferable Allowance was designed to enable married couples and civil partners to make use of both their Nil Rate Bands ("NRB") for IHT planning purposes. The NRB is the amount of an estate which is taxed at 0%, or is, in effect, "free of" IHT. This is currently £325,000 and is due to remain at this figure until 2028. If the value of the estate exceeds the NRB, then the balance would normally be taxed at 40% for IHT. (Please see out handout on Inheritance Tax for more details on IHT).

Background

Before 2008, for most married couples, IHT arose only on the death of the second of them to die. However, only one NRB was available to offset against the total value of their joint estates. The Transferable Allowance introduced measures to enable spouses and civil partners (or their executors) to claim the unused transferrable NRB allowance from the first spouse's or civil partner`s death for use by the estate of the survivor.

In summary, under current figures, provided the first spouse or civil partner left everything to, or for, the survivor – and had made no gifts to anyone else in the seven years before they died – the survivor`s estate should benefit from double their own NRB. Therefore, on current figures, a married couple or civil partner could have up to £650,000 "free of IHT" when they have both died. (£325,000 x 2).

Many families are potentially subject to IHT due to the value of their house and they may have little scope to make use of the lifetime planning steps available, such as the lifetime gifts for IHT outline in out Inheritance Tax handout.

Before the introduction of the Transferable Allowance, IHT planning Wills incorporating the so-called Nil Rate Band Discretionary Trust ("NRBDT") (with the facility to carry out planning with the family home) were a very effective, and flexible, form of tax planning. This scheme enabled married couples and civil partners to make use of both their NRBs. This would mean that, under current figures, their estates could have up to £650,000 "free of" IHT. (£325,000 x 2). This could result in an IHT saving of up to £130,000 (£325,000 x 40%).

The Transferable Allowance enables married couples and civil partners to make use of both NRBs without the need of necessarily using detailed tax planning Wills. (Tax planning Wills should, however, still be considered where, for example, flexibility is required; where people own business or agricultural assets; or where it is wished to "protect" money from actually passing to the surviving spouse or civil partner absolutely, for example in a second marriage or for asset protection reasons. If you would to consider any of these please contact me).

Since the introduction of the Transferable Allowance, a Will leaving everything to each other and then, for example, to your children or other parties, should now be IHT efficient.

How the Transferable Allowance Operates

When the first person dies everything will still normally pass to the surviving spouse or civil partner "free of" IHT. When the second person dies their own NRB will be available as before (subject to any gifts they may have made within the previous seven years). Their executors will then look at applying to use the Transferable Allowance if the value of the joint estate exceeds the second person's NRB.

The executors need to determine what proportion of the first person's NRB was unused when they died. If, for example, they had left everything to, or for, the surviving spouse or civil partner, everything will have passed "free of" tax and 100% of their NRB should have been unused. (As mentioned above, it would also be necessary to check if any gifts had been made in the seven years prior to the first person's death, as such gifts would affect matters).

The executors can then apply to add the unused proportion of the first person's NRB to the second person's estate. Therefore, there could be a joint NRB of £650,000 available on current figures. (£325,000 x 2).

However, unlike with the tax planning Wills mentioned above, rather than applying the NRB which was in force when the first person died (which may have been lower than the rate when the second person dies) they will apply the second person's NRB. Therefore, if when the first person died the NRB was £325,000, but the second person's NRB had increased to, say, £400,000, the total joint NRB available would be up to £800,000 (i.e. 2 x £400,000).

If, however, the first person had left say half of their NRB to their children (or someone else) – either in their Will, or in a gift in the 7 years before they died - then only half of their NRB would be available to be transferred to the second estate. Therefore, if the first party's NRB was £325,000 in this example, it would mean that the NRB available on the second death would be £487,500 rather than the £650,000 noted above. (£325,000 + £162,500 – i.e. 50% of £325,000).

Another benefit of the new regime is that if the first person to die did not have assets in their sole name to the value of the NRB – such as if most assets were held jointly, or most assets were held in the other partner`s name, such as for income tax reasons - this no longer matters, provided all their assets passed to, or for, the surviving spouse or civil partner. Again, 100% of their NRB should be available to transfer to the second estate, as outlined above.

It does not currently matter when the first party died provided the second party died after 9th October 2007 – the principle of being able to transfer their unused NRB still applies. (However, if the first death was prior to 1974 there may be complications).

Existing Wills

If tax planning Wills had already been prepared incorporating the NRBDT, there are three main options available:

1. Change the Will to remove the trust so that the Transferable Allowances will operate in due course;

2. Retain the Trust and do nothing. Under current legislation it is possible to bring the Trust to an end after the first person has died and to make use of the Transferable Allowance instead. Such steps cannot be taken within three months of the first person dying, but must be taken within two years of their death; or

3. Retain the Trust and use it once the first person has died.

What Is the position if one party has already died?

Where someone has already died and their Will incorporated the NRBDT, it may be possible to make use of option 2 within two years of their death. In this case, their trustees (normally the same people as the executors) could transfer the funds to the surviving spouse or civil partner, even if the trust has already been set up. In this way, it will be treated as if the first person's NRB had not been used and the Transferable Allowance referred to above will apply.

Unfortunately, if the first person died more than two years ago this option is not available. However, as mentioned, tax planning Wills prepared prior to 9th October 2007 were, and are still, effective and can save up to £130,000 IHT, based on current figures.

This handout is for information purposes only to cover the basic principles and should not be relied upon. If you would like to discuss IHT, gifts or IHT related matters, please contact me and I will be very happy to discuss this with you further.

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