WILLS: THE TRANSFERABLE NIL-RATE BAND (TNRB)

Amid all the excitement of this year's Finance Bill, Government U-turns etc, one of the most interesting developments for individuals, so long as they are married or in a registered civil partnership is the 'Transferable Nil-Rate Band' (TNRB). Introduced by the Chancellor's Pre-Budget Report last October, the new regime applies where the second death occurs on or after 9 October 2007, regardless of when the first death occurred (though see below under 'Where the First Death Occurred Under Capital Transfer Tax (CTT) or Estate Duty') and depends on a claim being made following the second death. For the technically minded, the Finance Act 2008 has introduced new sections 8A, 8B and 8C into Inheritance Tax Act 1984 (IHTA 1984). References below to 'spouse' should be taken as including registered civil partners.

How Does the TNRB Work?

Where the nil-rate band (NRB) of the first to die was not fully used in calculating the inheritance tax (IHT) liability in their estate, the unused proportion is carried forward to the second to be added to the NRB on the second death (expressed as a proportion of the NRB used on the first death).

HMRC have confirmed that it does not matter that the chargeable estate on the first death was less than the then NRB.

It is a mistake, as some newspaper commentaries have done, to refer to an NRB for a married couple or civil partnership of £624,000 (in 2008/09). This is because advantage can be taken of s8A only in computing IHT on death: chargeable lifetime transfers are taxed in the ordinary way.

Examples

Edwin died in 1996 leaving his entire estate to his wife Lena. Lena died on 1 July 2008 when the NRB is £312,000. Providing a claim is made, the NRB in Lena's estate is £312,000 x 2 = £624,000.

Betty died on 1 January 2008 leaving £150,000 equally to her three children and the rest of her estate to her husband Charles, so using 50% of her NRB (in 2007/08). If when Charles dies the NRB has increased to say £1 million, the NRB in his estate can on a claim be increased by 50% to £1.5 million.

When The TNRB Will – and When it Won't - Help

The TNRB is available (up to a maximum of 100%) to cover all chargeable gifts on the second death. This would include potentially exempt transfers (PETs) which become chargeable by reason of death within seven years, property given in which the donor reserves a benefit at their death (so clawing the value back under the reservation of benefit rules), as well as property within a qualifying interest in possession trust which is treated as belonging to the beneficiary (under IHTA 1984 s49(1)).

The proportion of the NRB which is carried forward from the first death is calculated by reference to the death estate. So, for example, if the first to die left a NRB gift to trustees of a discretionary trust, that on the face of it would eliminate any TNRB. However, if within two years of the death the trustees appoint all the assets out to the surviving spouse, at least three months after the death, that writes the spouse exempt transfer back into the Will (IHTA 1984 s144). PETs made within seven years of death will necessarily become chargeable and so eat into the available NRB.

Where the First Death Occurred Under Capital Transfer Tax (CTT) or Estate Duty

IHT replaced CTT in 1986. The spouse exemption was available under CTT as under IHT. Note incidentally that under both taxes there is a limitation where the transferor spouse is UK domiciled for all IHT purposes and the transferee spouse is not. The exemption is limited to £55,000 (currently). Domiciled for IHT purposes includes the special deemed domicile rule whereunder a person who is domiciled outside the UK under the general law is

treated as deemed UK domiciled if he has been resident here for at least 17 out of the last 20 tax years or he has been domiciled in any part of the UK within the last three calendar years.

CTT replaced Estate Duty in 1975. However, only for the last five months of Estate Duty was there a complete spouse exemption. For the two years before that it was limited to £15,000 and prior to 12 March 1972 there was no exemption at all. Accordingly, where the first spouse died under Estate Duty the TNRB is unlikely to be of much help except where the chargeable estate was very small (below the then threshold) or was covered by an exemption such as the charities exemption or the exemption for deaths by reason of wound, accident or disability incurred on active military service (under IHTA 1984 s154).

Incidentally, there remains a very valuable relief from IHT where on the death of the first spouse under Estate Duty a life interest trust was established for the survivor (which became exempt from Estate Duty from the second death). This rule has been carried over first to CTT and then to IHT. Such ‘Estate Duty protected’ life interest trusts should generally be left undisturbed, as providing both the IHT exemption on the second death together with the Capital Gains Tax free uplift to market value at that point.

So Is This Good News?

The answer is, in general terms, ‘yes’. Consider the strategy, where both spouses are still alive, of ensuring that no part of the NRB of the first to die is used. Assets can then be passed to the survivor (say, the wife) either to keep for herself or to make gifts as PETs to the children in the hope of surviving by seven years to make them exempt. The same structure could be achieved under a trust for the survivor called an ‘immediate post-death interest’ (IPDI) under which the trustees could, no doubt in consultation with the survivor, bring the interest to an end to an extent by making gifts to the children, which has the same effect as outright gifts.

The TNRB would really come into its own if there were a very big hike in the NRB. For example George Osborne the Shadow Chancellor was saying last year that under a Conservative Government the NRB would be increased to £1 million. So if this were to occur in a couple of years’ time, a death now not using the NRB of £312,000 followed by a second death in say three years time could create a combined NRB on the second death of around £2 million - an additional £688,000 or an additional IHT saving of £275,200. Indeed, while a topic for another Briefing, such a sudden and dramatic increase would have a hugely dramatic and beneficial effect on calculating the ten-year anniversary charge in many discretionary (or, now, ‘relevant property’) settlements.

When Might it be Sensible to Use the NRB on the First Death?

While generally helpful, the new rule should not be regarded as providing the best structure in all circumstances. For example with a view to protecting an interest in the home from liability for care fees, it might be sensible to have the share of the first to die going into some form of trust arrangement. Second, subject to any extreme increases in the NRB, it could be that the capital appreciation in the NRB Will Trust outstrips future increases in the NRB. Third, it might be desired, perhaps for non-tax reasons, to have two NRB trusts for children/grandchildren going forward, the one established under the Will of the first to die and the other set up perhaps shortly after by the survivor. Fourth, there is the point that, again subject to any big increases in the NRB, if such a trust is to be kept going for at least ten years, there could be a positive charge to IHT (of up to 6%) on each ten-year anniversary. For this reason it might be better to have two smaller trusts going forward than one large trust.

There is one category of property which should definitely be the subject of a chargeable transfer on the first death, namely assets attracting business or agricultural property relief at 100%. While not involving any IHT and so preserving the TNRB for the survivor, this technically takes the form not of an exempt transfer, but of a chargeable transfer albeit one relieved at 100%.

Are There Any Caveats?

The Finance Act 2008 had Royal Assent on the 18 July 2008. This meant theformal enactment of the TRNB, with effect from 9 October 2007.

There is one other point. It is assumed that the spouses/civil partners are generally agreed on how best to deploy the family property, no doubt for the ultimate benefit of the children/grandchildren. But the unexpected does happen: for example, in the context of other relationships forming after the first death which could conceivably cut out the children/grandchildren (especially, perhaps, from a former marriage) whom the first to die would have wanted to benefit. Such issues can generally be covered by the use of a trust or IPDI structure and should always be considered, however unlikely the prospect at the time.

Watch Gifts of Chattels and Other Property Within Two Years After the Death

There is a very useful rule (in IHTA 1984 s143) concerning what are called 'precatory trusts'. These are often used in conjunction with chattels in Wills. If the testator leaves chattels or other property say to his wife and expresses a wish that within two years after his death she gives all or any of them to named people and she does so, it is the gift to the ultimate beneficiary which is written back into the Will, so creating a chargeable gift. (Of course the point could also work the other way round: if father left a painting to his son with the wish, however improbably, that he passed it back to his mother and he did so within two years, this would then become a spouse exempt gift to the widow – providing there was no 'deal' that she should simply give it back to her son.) The reason of course that such a rule is very useful with chattels is that people do change their minds from time to time and so a straightforward gift to the surviving spouse coupled with the letter of wishes which can be changed without coming back to the solicitors is a helpful facility.

However, s143 is very widely drawn, and therefore almost inadvertently the survivor could bring herself within the scope of the rule by transferring any property to say a child in reliance on the wish. This would be very bad news in terms of failing to preserve the TNRB. Incidentally, the trap could be easily avoided by ensuring that chattels, if not all property, are left to the survivor on an IPDI, such that any gifts of chattels etc are effectively made by the trustees, causing the survivor to make a PET but preserving the NRB.

The Family Home

Some of the issues connected with IHT-efficient gifts of the family home were covered in our Technical Briefing of July 2007, especially following the Special Commissioner's decision in the *Phizackerley* case. The TNRB is excellent news in terms of the family home, as a share in the house of the first to die can simply be left to the survivor without the need to worry about how to use the NRB in relation to a share in bricks and mortar on the first death.

What Happens if the First Death Has Already Occurred?

History cannot be rewritten: the problem is that in the past it has been traditional accepted wisdom to ensure that the NRB is fully used on the first death. The only qualification here is where the first death has occurred within the last two years and the NRB was used in constituting what is called a NRB discretionary trust including the surviving spouse/civil partner as a beneficiary. It remains open for the trustees to appoint the trust fund either to the survivor absolutely (at least three months after the death) or to an IPDI for a survivor, so long as either occurs within two years after the death. This effectively reinstates the NRB.

Alternatively, if on a death within the last two years the NRB was made up of absolute gifts to the children (being of full age) they could vary the Will (under IHTA 1984 s142) and pass the property back to the survivor. Again that would treat the survivor as taking under the Will and preserve the NRB. The only caveat is that the survivor should then not immediately make gifts back to the original beneficiaries, as HMRC might well say that that rendered the variation null and void.

Survivorship Clauses

There is a useful rule (in IHTA 1984 s92) for any gift under a Will which is made subject to a condition that the donee survives for a period not exceeding six months. If the condition fails, so does the gift and a substitutionary gift takes effect. Failing such a condition there would be no additional IHT (given what is called 'quick succession relief' at 100%), but there would be the administrative hassle of having the asset(s) concerned go into and then out of an estate in short order.

Usually survivorship clauses will be found with periods from 30 days to three months. Generally, with the TNRB it is probably sensible to avoid a survivorship clause for a gift to a surviving spouse or civil partner (and see also the next paragraph below). If the deaths were to occur within say a 30-day period in the same tax year it would surely make no difference, except perhaps in the event that in the estate of the first to die there were insufficient assets to make use of the NRB if there were such a clause. Incidentally, that is one reason why accepted wisdom has always been to ensure that there is sufficient value in each estate to make use of the NRB (before 9 October 2007) regardless of the order of deaths. Of course, inclusion of survivorship clauses could make a difference if say one spouse died on 30 March and the second on 20 April, with a difference in the nil-rate bands as between the tax years. Generally, especially given the curious point made in the next paragraph, it is thought sensible to avoid survivorship clauses now for spouses/civil partners.

Consider a '*commorientes*' case, a Latin word covering the case where both spouses die in circumstances where it cannot be told which, if either, survived the other even for a very short space of time, typically the plane crash or the car crash scenario. There is a curious mismatch between the IHT provisions and the succession law rules. Succession law (under Law of Property Act 1925 s184) treats the younger spouse as surviving – and so there could

be a difference in outcome if following a gift to the spouse the two Wills left the residue of the estate to different people. For IHT purposes by contrast neither spouse is treated as surviving the other (IHTA 1984 s4(2)). The effect is that, provided the elder spouse has made a Will, his estate is treated as passing momentarily (the famous '*scintilla*' of time) through that of the younger spouse down to the children. But there is no IHT charge in the younger spouse's estate because immediately before she died (the time at which the estate is identified) she had not yet inherited anything from her husband. This anomaly occurs very rarely, though it does happen, and it is useful to take advantage of it where at all possible (by ensuring no survivorship clause in the elder spouse's estate).

Multiple Spouses/Civil Partners

It is not uncommon for the survivor to remarry. There is a limitation of the TNRB to a 100% uplift on the second death. So if a person has survived two spouses neither of whom used their NRB, the NRB on that individual's death cannot be increased by more than 100%. But interesting possibilities present themselves. Generally it is for the survivor's personal representatives to make a claim for the TNRB within two years from the end of the month in which the survivor dies. However, if they fail to make such a claim, then any other person who is liable to the tax on the survivor's death can make a claim within such later period as HMRC may allow. Consider the following scenario.

Example

Leonard died in 2000 leaving all his estate to his wife Alison. Alison then married William in 2003 and has just died (in May 2008) with a chargeable estate of £312,000 which she leaves to her own and Leonard's daughter Caroline. Being within the NRB there is no reason for Alison's executors to claim Leonard's NRB. However William, or rather perhaps William's children, might wish to maximise Alison's NRB. So could William's estate (on his eventual death) get the benefit of Leonard's NRB against Alison's chargeable gift of £312,000, leaving Alison's estate with a full unused NRB to be used on William's death? This seems possible in principle, however curious it may appear. Indeed, HMRC's draft guidance on the TNRB confirms that William's executors can make such a claim under IHTA s8B(2) within the permitted period after William's eventual death, in effect doubling up William's NRB, given that the IHT implications in Alison's estate (none payable) would not be altered.

Do I Need To Change My Will in the Light of the New Rule?

This rather depends on what the Will provides. If the Will already simply leaves the whole of the estate to the survivor, subject perhaps to surviving for 30 days (though see above) and then to the children, nothing may need be changed, except perhaps to delete the survivorship provision. However, very many Wills will already have a discretionary trust of the NRB, including the survivor as a beneficiary, and this probably remains the best structure for the time being. This is so that all the circumstances, family and fiscal, at the time of the first death can be taken into account in deciding what to do.

Concluding Note

It is always nice to be able to report good news on the tax front. But it would be a brave person who forecast that in five, let alone ten, years' time the structure of IHT (or in 'old speak' death duties) will remain the same including the exemption for spouses/civil partners. So the moral must always be, as with estate planning in general: 'keep under review'. The Finance Act 2008 was passed on 1 July 2008 which confirmed the TNRB

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