

## **The Transferable Inheritance Tax Nil rate band allowance**

The recent introduction of the transferable nil rate band is having a significant impact on the legacy sector, causing a degree of uncertainty, increased legal costs and the very real possibility of a reduction in the level of legacy income passing to the charity sector. This fact sheet summarises the legal issues and highlights the areas where legacy officers should be seeking specialist advice.

### **What is the nil rate band?**

The inheritance tax nil rate band (NRB) allowance is the amount which anyone can leave free of inheritance tax, to anyone they wish.

In the current 2007/08 tax year, that amount is £312,000 per individual, less non-exempt gifts made within the last seven years or by the person's Will or Codicil.

### **Previous position**

Until the Finance Act 2008 was enacted, each individual's NRB allowance was available on a "use it or lose it" basis. To the extent that an individual did not make effective use of it before death or in his or her Will, the NRB allowance was lost.

This gave rise to rather complicated Wills being drawn up for married couples in order to crystallise the NRB allowance of the first spouse to die, thus making two NRB allowances available when the next generation eventually inherited, while also ensuring that the funds would be available for the surviving spouse during his lifetime.

### **The "transferable" nil rate band**

Following the Finance Act 2008, if the first spouse to die has not used all of his or her NRB, the percentage unused can be claimed to "uprate" the maximum NRB allowance on the survivor's death. This means that the NRB available on the second spouse's death can be significantly enhanced, sometimes by as much as double its value.

## Examples of how the transferable nil-rate band is calculated

### Example 1

Mrs Brown died on 1 July 2007. She had not made any gifts within the previous seven years. She left £15,000 to each of her two children and the remainder of her estate to her husband. Mr Brown died on 1 August 2008 and left everything to the children.

At the time when Mrs Brown died the NRB was £300,000. Mrs Brown used £30,000 of this in the gifts to her children, ie 10%, leaving 90% unused.

On Mr Brown's death the NRB is £312,000. The maximum NRB which can be claimed on Mr Brown's death is therefore  $£312,000 \times 190\% = £592,800$ .

### Example 2

If Mrs Brown had not made any non-exempt gifts in her Will then the maximum NRB on Mr Brown's death would have been double the NRB then applying, ie £624,000.

Note that this would apply even if Mrs Brown did not at the date of her death own assets in her sole name equal to the NRB allowance. Even if the first spouse had no assets in his or her own name, the unused NRB allowance can be transferred.

## In what circumstances can a claim be made?

In order for a claim to be made, the second spouse must have died **after 9 October 2007**. This is the case even though the Finance Act was not actually passed until July 2008.

If both spouses were already deceased before 9 October 2007 then no claim can be made.

It does not matter how long ago the first spouse died. Note, however, that under the Estate Duty rules, until 13 November 1974 there was no unlimited exemption for transfers between spouses. Between 21 March 1972 and 13 November 1974 the relief was capped at £15,000, and before that time there was no relief at all. Therefore, if the first spouse died in that era, they are quite likely to have used up at least some of their NRB allowance, and the uplift which can be claimed on the survivor's NRB will probably be less than 100%.

Note also that the spouses must have been married when the first spouse died. So, if a couple divorce and then one of them dies, no claim can be made on the survivor's death.

## What if the unused NRB arises as a result of a Deed of Variation?

It may be possible to make a claim for an enhanced NRB where a Deed of Variation was made following the first spouses' death. For example, the first spouse left a Will giving everything to her children. The Will was subsequently varied by a Deed of Variation to replace the wording with a gift of the whole estate to the surviving spouse. The first spouse would be treated as having an unused NRB allowance (subject to any other chargeable gifts she may have made) and the enhanced NRB might be applicable. It is important to note that a number of formalities must have been followed in order for the Deed of Variation to be effective for tax purposes. If those formalities were not followed at the time the Deed of Variation was made then the enhanced NRB will not apply.

## How is a claim made?

The enhanced NRB on the surviving spouse's death is not awarded automatically. It has to be claimed by the surviving spouse's Executors from HMRC on Form IHT216. The application must be supported with various documents such as a copy of the Will, death certificate and grant of probate, if relevant, for the first spouse to die. The claim must be made within 24 months following the end of the month in which the second spouse died.

## So what are the implications for charities?

It is not uncommon to come across a Will that leaves a legacy, determined by a formula linked to the NRB allowance, to family members, and then the remainder to charity. In this situation no inheritance tax is payable on the estate because, to the extent that it exceeds the tax-free NRB allowance, it passes to an exempt beneficiary (the charity).

Following the introduction of the transferable NRB allowance, however, there is a question as to whether the legacy to the family members should be calculated by reference only to the deceased person's own NRB allowance, or whether it should also have the benefit of the enhancement which could be gained from a claim in respect of the deceased spouse's NRB allowance, if available. The former leaves more funds in the residuary estate for the charity; the latter passes more to the family members and less remains for the charity.

### Example 3

Mr White died in August 2008 having made no significant gifts during his lifetime, leaving an estate of £700,000. In his Will he made a gift of the NRB to his children, with the residue passing to charity. His wife Mrs White had died in August 2007 leaving her entire estate to her husband.

If the NRB is calculated using just Mr White's NRB then the charity would receive approximately £388,000 (£700,000 - £312,000). However, if a claim is successfully made by Mr White's executors, for an enhanced NRB, then the charity would receive only £76,000 (£700,000 - 2x£312,000).

The example above demonstrates the impact on the amount a charity might receive under a Will, reducing the charity's share by up to £312,000 in the current (2007/08) tax year, if a claim for an enhanced NRB is successful.

In determining which of the above positions applies, it is an important point to note that the enhancement to the NRB allowance is **not** awarded automatically; it has to be claimed by the Executors. It is not possible for a person to put in a claim prior to his or her death.

## Construction of the Will: how much should the charity receive?

There is no easy answer to this question.

The starting point when considering whether a single or enhanced NRB should be applied is to look at the precise wording of each Will. One of the greatest difficulties for legacy officers is that there is no single preferred form of wording for a NRB legacy in a Will. There are many alternative forms of wording that a legacy officer might have to review and the question of whether the enhanced NRB can be claimed by the executors (resulting in a reduced payment to the charity) may not be readily apparent.

It is useful to consider two of the main forms of wording which might be used to express a NRB to illustrate the difficulties in applying the terms of the Will.

The first describes the legacy along the lines of **"...the largest amount which could be given without any inheritance tax becoming due on the transfer of my estate which I am deemed to make immediately before my death"**.

Arguably, this wording could be read as referring either

a) to the largest amount which the testator could personally leave without making inheritance tax payable – which would indicate that no account could be taken of the uprating effect, since that is a matter for the Executors' separate claim; or

b) to the largest amount which could possibly be given without liability to inheritance tax – in which case the wording could perhaps be stretched to include the additional step to be taken by the Executors in claiming the enhanced NRB allowance. This analysis would result in less being received by the charity because the legacy to the family would be increased; indeed, potentially doubled.

There are merits for and against both interpretations. For example, a testator leaving a Will including a NRB legacy will almost certainly have done so in order to give away as much as possible to non charitable beneficiaries without the estate incurring tax, which supports an argument for applying an enhanced NRB. Conversely, a Will might refer to the maximum amount which can be given away free of inheritance tax immediately **before** death, whereas an enhanced NRB could not be claimed until **after** death. The Executor has a duty to balance the interests of the beneficiaries and, in the absence of clear wording in the Will permitting him to do so, the Executor could be in breach of his duties by favouring the family member over the charity, if he were to make an application for the enhanced NRB to apply to the estate.

A second, popular form of wording is to express the formula for the NRB as **"the sum equal to the upper limit of the nil per cent rate band in the table of rates of tax applicable on my death... less the amounts chargeable to inheritance tax by reason of my death [under specific provisions which are then itemised]..."**

In this case it seems much more difficult to argue that the enhanced NRB allowance should be taken. The upper limit of the nil per cent rate band to which the formula refers will be the individual's own maximum NRB allowance – ie, in the current tax year, £312,000. The formula is comprehensive and makes no allowance for a claim to increase the maximum NRB allowance by reference to that left unused by the first spouse to die. This form of wording is more likely to indicate that the family should only receive up to £312,000 and the remainder should all fall into residue and pass to charity.

## **'Capped' nil rate band legacies**

Sometimes a legacy of the NRB may be capped by a specific figure or even possibly a percentage of the estate. Testators have for some time been aware that the NRB allowance continually changes and may have wished to guard against an unexpectedly large increase disrupting their scheme of inheritance. In that case the legacy cannot exceed the amount or percentage stated by the testator, even if the amount which could be claimed as being free of inheritance tax would be greater.

## **How can a charity decide which approach should be taken?**

This is a complex area of law. The wording of individual clauses will vary from one Will to another and even where standard Will precedents have been used, the addition or removal of a single word in a Will could alter the way in which the estate should be distributed.

This legislation is still very new and until a case has been dealt with by the courts it is difficult to give definitive guidance on the way in which estates should be distributed under these clauses.

Over time, patterns are likely to emerge and it will become easier to give guidance on which clauses are most likely to attract an enhanced NRB and which are not.

In the meantime, Legacy officers are advised to take legal advice on the interpretation of specific clauses, before approving an Executor's application for an enhancement to the NRB, which would result in a reduction in the payment due to the charity.

## Which estates will not be affected by an enhanced NRB?

- Where both spouses died before 9 October 2007
- Where spouses were divorced prior to the first spouse's death
- Where the first spouse used up their full NRB (either through legacies or lifetime gifts)
- Where the NRB is capped at a particular limit, which is the same as or less than the current NRB.
- Where the second spouse died after 9 October 2007 and 24 months have passed since the end of the month in which the second spouse died and no claim has been made by the Executors.

## Recommendations

If a situation arises in which the amount received by your charity under the Will is determined by the interpretation of a legacy calculated on a formula referable to the NRB, and the Executors are indicating that this is affected by a claim for a predeceased spouse's NRB to be transferred, it is a good idea to obtain specific legal advice on the point.

If you agree that the NRB formula is affected by a claim for NRB uplift, you could still request evidence that HMRC agree with the Executors' claim and calculations.

In the following, the masculine is intended to include the feminine and vice versa; and references to spouses include civil partners under the Civil Partnership Act 2004.

## Contact

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