

What is a Nil-Rate Band Discretionary Trust?



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It is a trust that secures your available Nil-Rate Band (inheritance tax-free amount) for your chosen beneficiaries. It is part of your will and comes into effect on death.

What do you mean by available Nil-Rate Band?

The Nil-Rate Band (NRB) is the tax-free amount you have as an individual before inheritance tax is due. The maximum amount is £325,000 until April 2030.

The amount of available NRB you have on death, can be reduced by any chargeable lifetime transfers (e.g. gifts, transfers into trust) you make within seven years of your death.

What are the benefits of a Nil-Rate Band Discretionary Trust (NRBDT)?

An important feature of an NRBDT is there are typically no inheritance tax charges during the first ten years of the trust due to the limit of the NRB. If the trust still exists, the trust fund will be revalued upon its ten-year anniversary and every ten years thereafter. If the value of the trust fund exceeds the available nil rate band, ten-year anniversary charges (maximum of 6% over the NRB) and exit charges will apply.

NRBDTs are useful where there are assets likely to increase in value as the growth occurs within the trust and does not add to an individual's taxable estate.

Who can an NRBDT help?

Unmarried couples do not benefit from any spousal exemption or transferable inheritance tax allowances. Depending on the size of the estates, the risk of paying inheritance tax on both first and second death increases.

Widows and widowers who have remarried can save unused inheritance tax allowance from a deceased spouse that would otherwise be wasted.

Married couples with children from former relationships may want to use an NRBDT to protect part of their estate for their own children and without creating an inheritance tax problem for their spouse. There is flexibility over who can benefit (including your spouse).

Married couples with combined estates of over £2 million will not qualify for the full Residence Nil-Rate Band (RNRB). If you have a high-value estate, including an NRBDT in your will can reduce the value of the estate that passes directly to your spouse.



How does an NRBDT work?

In your will, you say who you want to benefit from the trust and who you want to manage the trust (your trustees). Your beneficiaries can be individuals or named groups (e.g. grandchildren).

After you have died, your executors will identify your assets and any debts to others.

They will need to obtain probate and pay any inheritance tax that is due.

Apart from any specific gifts in your will, the executors may transfer cash, property or other assets up to the value of your available NRB to your chosen trustees (who may or may not be the same people as your executors).

A letter of wishes is a confidential document that can guide your trustees over how you want the trust fund to be used. It is not legally binding on your trustees.



Trustees have control and discretion over the use of trust assets so it is important that you choose wisely. They can make decisions based on the needs of beneficiaries and tax rules at the time. They can decide whether to keep the assets in the NRBBDT, change it to an Interest in Possession Trust, make gifts or loans to beneficiaries or end the trust if it is not needed.

What are the disadvantages of using an NRBBDT?

Trusts are formal legal arrangements that must be set up and managed properly. An NRBBDT must be registered with HMRC if the trust exists two years after death or within 90 days of a UK tax liability arising.

Trust tax returns may also need to be completed if the trust receives income, has a capital gains tax liability or to pay inheritance tax exit charges on capital assets leaving the trust if the trust has continued for ten years and has exceeded the NRB.

If you appoint family or friends as trustees, most will need professional advice to understand their options, tax reporting obligations and manage the trust correctly. Trust administration expenses are deductible from the trust fund.

Whilst an NRBBDT can help with inheritance tax planning, it is important to note that the Residence Nil-Rate Band will not be available if a share of the family home or other qualifying property forms part of the trust unless the trustees transfer this out of trust to qualifying beneficiaries (e.g. children, grandchildren) within two years of the deceased's death.

As with all trusts and estate planning, getting professional advice regarding your own situation is essential. Contact us today.

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