

Update on Will Trusts

Background

As part of Navigator's holistic financial planning process, we seek to reduce the exposure of our clients' wealth to Inheritance Tax (IHT). One of the ways we do this is by recommending that husbands & wives, and following recent changes in legislation, civil partners, should incorporate Nil Rate Band trusts into their wills. This utilises the Nil Rate Bands of both spouses and potentially saves the estate £120,000 in IHT (2007/08 figures). In order to give maximum effect to this strategy, and maximum flexibility to the surviving spouse, we occasionally recommend that the family home be owned as a tenancy-in-common, and include a debt or charge clause in the wills. The Commissioners of the Inland Revenue recently won a case against the estate of a Dr Phizackerley (Dr P) by attacking a specific use of such an arrangement. The case has been well publicised in the national press and clients may be concerned that this may invalidate their IHT planning.

The Phizackerley Issues

Dr Phizackerley was a consultant biochemist, but his wife (Mrs P) never worked during the marriage. During his working life, accommodation was provided by his employer and, on his retirement, the couple bought a house in joint names.

Key Point 1 – the funds for the house were deemed to have come from Dr P only, as he was the sole earner.

Four years later, the property was transferred to a tenancy-in-common, wills including Nil Rate Band trusts were drawn up, and very shortly thereafter Mrs P died. Instead of passing ownership of her share of the property into the will trust, her bereaved husband promised to pay the value of the Nil Rate band to the trustees and her assets passed into his name. Another two years later, Dr P also died.

Key Point 2 – the Nil Rate Band on first death was settled by way of an IOU.

Key Point 3 – the collateral for the IOU was an asset (the house), once owned by Dr P, given to his wife, and passed back to him in her will.

The outcome

The Inland Revenue successfully argued (using Finance Act 1986 s.103 for the very interested) that a loan from a donee to a donor, secured against assets that had been gifted by the donor to the donee, was not deductible from the estate of the donee.

The Court decided that the loan that Dr P made to his wife's will trust should not have been deducted from his estate before calculating the IHT bill. This resulted in additional IHT becoming payable.

Who does this case affect?

In general, the following groups of people are affected.

For married couples and civil partners

- Has one spouse or civil partner never worked during the marriage?
- Was the house purchased as a joint tenancy, and transferred to a tenancy-in-common?

If the answer to both questions is, Yes, then a further discussion would be wise.

For widows & widowers

- Did the surviving spouse not work at all during the marriage to the late spouse?
- Is the surviving spouse still living in the house owned with late spouse?
- If so, it was it bought as a joint tenancy, and later transferred to a tenancy-in-common?
- Was the Nil Rate Band trust in his or her will settled by the surviving spouse giving an IOU to the trustees?

If the answer to all of the above questions is, Yes, then some action may be needed

Comment

The circumstances in which the Phizackerley decision will apply are fairly limited. As usual, that has not stopped the media from making a fuss, which may raise concerns which, in most cases, are not justified. Nil Rate Band trusts still work; debt or charge clauses still work: the case has simply demonstrated that care is needed in their implementation.