

The Flexible Life Interest Trust

The changes to Inheritance Tax rules announced in the Pre Budget Report last October have seen the demise of the Nil Rate Band Discretionary Trust for most clients. So what now for Willwriters and their clients? Paul Sharepe, Institute of Professional Willwriters' Chairman, looks at one option that is popular with his clients.

The new rules on Inheritance Tax (IHT.) are great news for married couples because they allow the executors of the estate of a surviving spouse to claim an uplift in their Inheritance Tax allowance of the percentage amount of the allowance of the first spouse to die that was not used by gifts to non-exempt beneficiaries.

Confused?

Well, say Jack died in 2006 – when the Inheritance Tax allowance was £285,000 and he left his estate of £250,000 to his wife, Jill. Jill dies in late 2010 when the Inheritance Tax allowance is £325,000 and, say, her estate is £50,000. Jill's executors are able to claim a 100% uplift in Jill's Inheritance Tax allowance because on Jack's death, his Inheritance Tax allowance was not used at all because he passed his estate to his wife who is a beneficiary exempt from paying Inheritance Tax. So, Jill's Inheritance Tax allowance is uplifted from £325,000 to £650,000 and her estate pays no Inheritance Tax, even though her estate is above her Inheritance Tax allowance.

So, married couples don't need to make Wills then?

Well, as a Willwriter, I could trot out no end of reasons why everyone should have a Will. From an Inheritance Tax mitigation point of view, married people need to ensure that on first death, their estate passes to the surviving spouse – a beneficiary exempt from Inheritance Tax. This ensures that the survivor's Inheritance Tax allowance can be uplifted by the maximum amount. The only way this can happen is through a Will, because a surviving spouse does not have rights to take the entire estate under intestacy.

So, married couples can write straightforward Wills 'leaving everything to each other'?

Yes- and no. Again, from a purely Inheritance Tax mitigation point of view, under current legislation, a simple Will is an option. But what if the Inheritance Tax rules change again? What if the surviving spouse remarries? What if the surviving spouse goes into a care home? What if a new rule comes in which nobody has thought about to date?

So, can I have my cake – and eat it?

The good news is – Yes. The solution is a trust created by a Will which is being dubbed 'The Flexible Life Interest Trust' or FLIT.

This Trust is created on the death of the first spouse and the capital assets of the deceased are held in a trust which pays any income generated to the surviving spouse for their lifetime. This is treated for Inheritance Tax purposes as an outright gift to the surviving spouse, so does not create a tax charge and does not use any of the Inheritance Tax allowance of the deceased spouse – preserving it for later use on the death of the surviving spouse. On the death of the surviving spouse, the trust capital is passed to nominated beneficiaries, such as children. Because the capital in the trust is not owned by the surviving spouse, it cannot be given away by them to, say, a new husband or wife, and it cannot be assessed if the surviving spouse needs to end their days in a care home.

The Trust:

- Includes powers for the trustees to lend trust capital to the surviving spouse. So if they need capital, the trustees can lend it to them – with the capital being repaid either when the surviving spouse dies or if they go into care
- Includes powers for the trustees to give capital to the surviving spouse. It is unlikely that this power would be used because the capital would then be owned by the surviving spouse and could be given by them to a new husband or wife and would be assessed if they went into care. However, we are trying to create a flexible trust to cover eventualities both foreseeable and unforeseeable – and this power, for example, enables the trust to be wound up and the whole estate given outright to the surviving spouse.
- Includes powers to pay capital to the nominated beneficiaries (children, for example) so that if children need capital and the surviving spouse does not (for example, if the surviving spouse is in a care home and the children are in need of capital to reduce their mortgages), capital in the trust could be paid to them.
- Includes powers for the trustees to convert some or all of the trust into another type of trust. So if, for example, INHERITANCE TAX laws change and make it preferable for the trust capital to sit in, say, a Nil Rate Band Discretionary Trust, the trustees could do this.

If this FLIT is so good, should I have always had one in my current Will?

The fact that a FLIT can be converted into any type of trust, including an INHERITANCE TAX saving Nil Rate Band Discretionary Trust has led to a number of my clients who had tax problems questioning why a FLIT was not recommended to them before. And I have to admit that they have a good point. However, it should be remembered that the work to convert a FLIT into a Discretionary Trust, for example, would be greater than the work to set up a Discretionary Trust created in a will. In cases where it is (or was) known that a Nil Rate Band Discretionary Trust is (or was) definitely beneficial to save INHERITANCE TAX, I still believe that it is (or was) the best advice.