

“ Plain speaking legal advice ”

**Nil Rate Band Discretionary Will Trust  
and the Case of Phizackerley**

## Nil Rate Band Discretionary Will Trust and the Case of Phizackerley

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A number of people have expressed concerns to us about the possible adverse impact of the above Case on Nil Rate Band Discretionary Trusts included in their Wills.

In simple terms for something like 95% of cases the Phizackerley Case is completely irrelevant and will have no adverse effect on the operation of a Nil Rate Band Discretionary Will Trust.

The problem highlighted in the Phizackerley Case is one that Herrington & Carmichael have been aware of for a considerable time and it has been drawn to the attention of Clients likely to be affected by it. More importantly in most cases where it is relevant it is possible to avoid the trap into which the late Dr Phizackerley fell.

It must be understood that a Will Containing a Nil Rate Band Discretionary Trust is merely a framework around which the Trust is constructed after the first party to the marriage dies. Typically the Trust is set up with a loan set against the half share of the matrimonial home owned by the deceased spouse. Where no such loan arrangement is going to be required then Phizackerley is wholly irrelevant

The most common circumstances in which the Phizackerley trap arises is where the matrimonial home was financed entirely by the husband's earnings his wife having not had any meaningful employment and no separate wealth of her own. This is the scenario that applies less and less frequently nowadays but this of itself is not enough to spring the Phizackerley trap.

A second factor must arise before the Phizackerley trap is sprung, and that is for the wife to die first. Whilst this does of course happen sometimes and certainly had happened in the Phizackerley Case, it is statistically a relatively rare event, men after all are the weaker sex, certainly where life expectancy is concerned!

In such circumstances a Nil Rate Band Discretionary Trust with a loan cannot be set up using an IOU from the surviving spouse. This was at one stage commonly used in almost all

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Nil Rate Band Discretionary Trusts. Instead of using an IOU the Trustees of the Nil Rate Band Discretionary Trust have to find another way to implement the Discretionary Trust. This can normally be done by one of several methods.

- a. The Executors impose a charge on the matrimonial home before it is put into the sole name of the surviving spouse. In practical terms this is little different from the IOU route but in legal terms it is completely different.
- b. Alternatively a half share of the matrimonial home into the Discretionary Trust. There can be Capital Gains Tax problems associated with this and it is not normally the favoured route.
- c. Where there are substantial cash assets these can be put into the Discretionary Trust thereby avoiding the need for any form of IOU or loan. This is only practical if the wife has had cash and investments transferred to her during her lifetime and for many couples is not practical.

For those interested in the technicalities of the situation the Phizackerley Case arises from the provisions of Section 103 of the Finance Act 1986. This is an anti Tax avoidance provision designed to prevent the creation of artificial loans that could be used to reduce the size of someone's estate for Inheritance Tax purposes.

Where the person borrowing the money is the original source of the money borrowed Section 103 disallows the debt. In the case of a husband who purchased the matrimonial home and was the source of all the family wealth a Nil Rate Band Discretionary Will Trust set up with the IOU means that in effect the Inland Revenue regard the husband as having been the original source of the funds and therefore caught by the Section 103 trap. This then means that the entire value of the former matrimonial home forms part of the estate of the husband and this is precisely what happened to Dr. Philzackerley. The Inland Revenue's argument completely ignores the value of a woman's contribution as a homemaker something that curiously contradicts with the law relating to divorce.

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There have been some suggestions that the Inland Revenue's approach is contrary to Human Rights and could possibly be challenged but this has been a line taken by the Inland Revenue for a number of years and the Phizackerley Case has simply strengthened their hand.

Fortunately the circumstances in which the trap arises are rare and in almost all cases there are ways of avoiding it.

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If you wish to discuss the issues above further in relation to your particular circumstances please contact Anthony Tahourdin on 01252 322451

Watchmoor Park  
Camberley  
Surrey  
GU15 3YL

tel: 01276 686222

4 Station Road  
Aldershot  
Hampshire  
GU11 1HU

tel: 01252 322451

51 Guildford Road  
Bagshot  
Surrey  
GU19 5NG

tel: 01276 451451

3&4 Market Place  
Wokingham  
Berks  
RG40 1AL

tel: 01189 774045

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