

Institution **CIOT - CTA**
Course **APS IHT Trusts and Estates**

Event **NA**

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Answer-to-Question-_1_

REPORT

TO: The Trustees of the Chandra Will Trust & the Chandra Discretionary Trust

FROM: 'Chartered Tax Advisers'

DATE: 11 MAY 2023

SUBJECT: Winding up of Avani Chandra Will Trust and proposed Transfer of shares in Traditional Storage Ltd.

INTRODUCTION

This report has been prepared for the Trustees of the Chandra Will Trust and the Chandra Discretionary Trust, 'Priya and Ravi', following their meeting with Fiona Smith.

This report will discuss the timing of the sale of the shares in Coastal Retreats Ltd. and the winding up of the Chandra Will Trust, and the proposed transfer of 5 shares in Traditional Storage Ltd. to Priya's son, Sunil.

This report is intended for the sole use of the the Trustees, and 'Chartered Tax Advisers' takes no responsibility whatsoever for any reliance placed upon this report by third parties.

This report has been prepared in accordance with the Tax legislation as it stands, as at 11 May 2023.

EXECUTIVE SUMMARY

- The Avani Chandra Will Trust now falls within the 'relevant property' regime for Trusts
- An Inheritance Tax charge will arise on any exits from the

Trust, as well as Capital Gains Tax in respect of property leaving the Trust and the Trust being wound up

- BPR should be available, at a rate of 100%, on the transfer of shares from the Trust (to reduce the IHT exit charge), on the basis that the company is mainly trading and providing services in relation to property letting

- If the Costal Retreats Ltd. shares are appointed to Priya and Ravi before the Trust is wound up, and the disposal made by them personally, the IHT due will be £nil, CGT due will be £25,000 (total - £12,500 each), and net proceeds will be £355,000 each

- If the Costal Retreats shares are sold within the Trust, and the cash funds then distributed on winding up of the Trust the IHT due will be £14,950, CGT due will be £23,770 and net proceeds will be £348,140

- Priya and Ravi will save £6,860 each if they appoint the shares first, and then sell them personally

- We recommend that Priya and Ravi appoint the shares before winding up the trust, and that this is done without delay (and before contract for sale) to preserve the entitlement to BPR

- The Chandra Discretionary Trust is also within the relevant property regime, any appointment of shares from the Trust to Sunil will therefore be liable to an IHT exit charge, and CGT

- A gift of shares directly from Priya to Sunil would still be a disposal for CGT purposes, but would constitute a PET for the purposes of IHT (on which no IHT would be payable if Priya survived the gift by 7 years or more)

- If the Trust transfers the shares to Sunil IHT of £nil will arise, and CGT of £6,770 will arise

- If Priya transfers the Shares to Sunil from her personal holding no IHT will be payable if she survives the gift by 7 years (although potential IHT exposure would be £63,600 otherwise), CGT of £49,000 will arise on the transfer
- A gift of shares from the Trust will therefore save £42,230 of CGT, and although the immediate IHT position is neutral, a gift from the Trust would prevent exposure to £63,600 of IHT on a direct gift from Priya (payable by Sunil), should she die within 7 years of the gift
- A dilution of Priya's shareholding in Traditional Storage Ltd. would further affect her future entitlement to BPR on the proposed investment of the commercial property, we therefore recommend that she maintains at least a 51% holding in the company going forwards (and that any purchase of the commercial property is made in her sole name, after an IHT free-transfer of funds from her spouse if required)
- We recommend, from a taxation perspective, that the gift of shares to Sunil should be made from the Trust (rather than directly from Priya), this is subject to the Trustees consideration of Jayesh's letter of wishes

A1 - Avani Chandra Will Trust (general principles)

The Trust as a Qualifying Interest in Possession (QIIP) on settlement as it was created on Avani's will, and the life tenant was Jayesh (her husband).

A QIIP forms part of the life tenant's estate for IHT purposes, and as such is not subject to Inheritance Tax (IHT) exit or principle charges.

As Jayesh has now passed, and the successive interest has passed to Priya and Ravi, the Trust no longer longer qualifies as an QIIP. Furthermore it does not meet the requirements of a Transitional Serial Interest.

The Avani Chandra Will Trust will therefore have now entered the relevant property regime. This will mean that IHT exit charges will apply to property leaving the Trust (which will be the case on the Trust winding up later in the year).

The exit charge will be based on an amount of notional tax payable on the 'initial value of the Trust'. And adjusted for the number of complete quarters between the creation of the Trust and the date of exit.

This will be reduced by the 'nil band' in force at the date of the property leaving the Trust (£325,000 presently - this is not due to decrease to the best of our knowledge).

The nil band is reduced by transfers made by the settlor in the 7 years prior to the Trust creation, The schedules you have provided do not appear to indicate any lifetime gifts were made but please do confirm this (for the purposes of the calculations we have assumed that there were none).

The 'initial value' of the Trust for the purpose of Business property (or agricultural property, where relevant), is not reduced for corresponding relief, although Business Property Relief (BPR) may reduce the charge payable on the exit itself within the first 10 years itself (more about this below).

The charge therefore is the calculated percentage multiplied by the value of property leaving trust (net of BPR).

Any assets leaving trust, and/or on winding up, will also be a

capital disposal for Capital Gains Tax (CGT) purposes.

The gain is calculated as the sales proceeds (or market value in the case of a transfer of the shares) less the base cost. This can be reduced by the Trust annual exempt amount of £6,150, with any remaining gains taxed at 20%.

As neither of the Trustees have worked as an employee or officer of company, there will be no eligibility for Business Asset Disposal Relief (BADR) in this case. (BADR would reduce the CGT rate to 10% subject to joint election by the Trustee and beneficiary, and subject to the lifetime limit of £1 million of gains not having been exceeded already.)

A2 - Availability of BPR

BPR, as noted briefly above, is an IHT relief. It reduces the value that is transferred for the purpose of IHT.

It is available to (although not limited to):

- Unquoted companies
- Which are Trading in nature
- The shares for which have been held for more than 2 years

The availability of the relief can be restricted where the company holds 'excepted assets' which are broadly, assets that have not been used within the business for the past 2 years, and are not required for future use in the business.

On the face of it, Coastal Retreats Ltd. would appear to *not* have any excepted assets, and as an unquoted company which has been held by the Trust for more than 2 years, it would appear to qualify for BPR.

There have been many cases where property letting companies, are seen by HMRC as (effectively) investment companies. The letting of land in itself is prohibited from qualifying for BPR.

However, hotel accommodation and B&Bs do qualify for BPR.

Furnished holiday lets (FHL) fall somewhere inbetween these two activities. While BPR is not strictly prohibited in the case of an FHL, the availability of the relief will very much depend on the level of service provided in proportion to simply letting of accommodation.

In cases where service is at the forefront of the business, and the business is truly or mainly (mainly being more than 50% of the business activities / time spent / revenue and profits generated etc.) BPR should be available.

The valuation document notes that Coastal Retreats Ltd. provides '*services to owners of furnished holiday lets*'. This being the case, the report conclusions are based on the premise that BPR will be available.

If this is not the case please inform us without delay so that we can discuss the company's activities in more depth.

It should be noted however, that where a binding contract for sale is in place prior to a Transfer of shares, BPR will be denied.

We understand that you have not yet entered into such an arrangement, and that you are in the discussion stages of sale, the report is therefore based on the premise that no binding contract for sale has been entered into and BPR will therefore be available to you on transfer.

In such a case BPR would be available at a rate of 100%.

A transfer of cash in itself (for example, if the shares were sold prior to the distribution of funds and winding up of the Trust) is not eligible for BPR.

A3 - IHT and CGT on distribution as shares (then private sale)

If the shares are appointed to Priya and Ravi and the Trust wound up in advance of sale/binding contract for purchase, BPR will be available on the Transfer of the business assets (ie. the shares) to reduce the value of transfer out of the Trust to £nil.

As a result the IHT exit charge arising will be £nil (Appendix 3).

Although no IHT would be payable, the exit from the Trust itself is still a chargeable event for the purpose of IHT.

As such, a holdover relief claim may be made such that chargeable gains arising on the distribution of the shares from the Trust to Priya and Ravi are 'held over' (under s.260 IHTA 1984) and charged on them, on the later disposal of the shares.

As such no CGT would be immediately payable, but a gain of £62,500 would arise to each of Priya and Ravi (Appendix 2).

This gain would be taxed on them personally. As they already use their personal CGT annual exempt amounts, and are both higher rate taxpayers, the CGT due would be £62,500 x 20% = £12,500 each.

The net proceeds of sale would therefore amount to:

£735,000 - 25,000 (CGT) = £710,000 x 50% = £355,000 each.

Priya and Ravi would both need to report the gains on their personal self-assessment tax Returns for the 2023-24 tax year,

due no later than 31 January 2025 (with CGT payable at the same time).

To preserve the integrity of BPR *in this case* it would be best to appoint the shares and wind up the Trust without delay.

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A4 - IHT and CGT on distribution as cash (having sold shares within the Trust first)

There will be an initial charge to CGT on share sale of the shares within the Trust. The Trust will pay the CGT arising, and will be eligible to use the trust's CGT annual exempt amount which will reduce the CGT payable slightly. The CGT due will be £23,770 (Appendix 4).

The gains would need to be reported via the Trust Tax Return for 2023-24 and the CGT payable no later than 31/01/2025 (along with submission of the Return).

An IHT exit charge will then be due on the appointment of cash from the Trust, no BPR will be available to reduce this as the Trust will not be making a transfer of qualifying business property. The IHT due will be £14,950 (Appendix 4).

The IHT due would need to be reported on form IHT100, and the IHT due paid within 6 months - assuming that the Trust (in this case) would be wound up September 2023, the tax would be due no later than 31 March 2024.

As such the net proceeds to Priya and Ravia (after all taxes have been discharged) will amount to:

£735,000 - 23,770 (CGT) - 14,950 (IHT) = 696,280 x 50% = 348,140 each.

A5 - recommendation for timing of sale and breaking of Trust

Appointing the shares to Priya and Ravi and winding up the Trust before a contract for sale is entered into, and Priya and Ravi selling the shares personally will save £6,860 (£355,000 - £348,140) each.

They should therefore look to assign the shares and wind up the Trust without delay, and make the sale of the shares personally on or after September 2023.

B1 - Chandra Discretionary Trust (general principles)

The Trust created by Jayesh on his death is Discretionary in nature (ie. the beneficiaries have no entitlement to the income or capital of the Trust).

The Trust is therefore subject to the relevant property regime ie. exit charges (as noted above) and principle charges (on each 10-year anniversary of the Trust).

Any appointment of property (ie. shares) from the Trust to Sunil will therefore be subject to an IHT exit charge.

The charge will again be based on the initial value of the Trust (with no relief for BPR), less the nil band in force at the date of transfer (we have again assumed that no transfers were made in the 7 years prior to the Trust creation), and adjusted for complete quarters from creation to exit.

As Jayesh was the original settlor, and the Trust entered straight into the relevant property regime without any spousal interest) the initial value of the Trust will be the probate value of the shares. according to the valuation provided, this

is £1,800,000.

Any appointment from the Trust would also be a disposal for the purpose of CGT.

B2 - Transfer from Priya (general principles)

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If Priya were to make a transfer to Sunil from her personal shareholding the transfer would be a 'Potentially Exempt Transfer' or a 'PET'.

There is no immediate charge to IHT in respect of the making of a PET. Where a donor survives a PET by 7 years then no IHT will become payable (discussed further below).

The transfer will also constitute a CGT disposal for Priya, therefore gains will become payable (this will include the gains previously held over on the original transfer of the shares from Avani and Jayesh to Priya).

B3 - Holdover relief (principles and availability)

As noted above in section A, where the transfer of shares from a Trust is made, and it is a chargeable transfer for the purpose of IHT (ie. it is accompanied by an IHT exit charge, or would be but for the availability of BPR).

Where this is the case, the trust, and Sunil (jointly and by joint agreement) may make an election for CGT holdover relief to apply (ie. to prevent an immediate charge to CGT, with Sunil receiving the shares with a lower base cost than the current market value).

In a similar fashion, a Transfer from Priya to Sunil, while not generating an immediate charge to IHT (and so not being eligible for s.206 holdover relief) *will* be the transfer of a qualifying

business asset for the purpose of s.165 IHTA 1984 - as such CGT holdover relief would be available to defer the gains under this section of the legislation.

However, both reliefs will be denied as Sunil is not currently UK resident (and while he is still UK domiciled, his intent is not to return to the UK for the next few years).

In both cases therefore, whether a transfer from the Trust or Priya, no holdover relief will be available, and all gains will be fully chargeable on the gift of the shares to Sunil.

B4 - BADR (principles and availability)

As Priya is an officer/employee of the company, and has been so for more than 2 years (and the company is her personal company, ie. she holds more than 5% of the voting rights) she will be eligible for Business Asset Disposal relief (BADR) on the gains arising from the shares.

Such a claim to relief would mean that the gains arising on the gift are taxed at the BADR rate of 10% (as opposed to the 20% that she would otherwise pay).

A claim for such treatment must be made within 2 years of the disposal, if taken up (although this is usually done via the self-assessment tax return on reporting) and would use some of her BADR 'lifetime allowance' (a cumulative total of £1 million). (For the purpose of this report we have assumed that she has not previously used any of this lifetime limit and the full £1 million limit is available to her).

As the Trust is Discretionary in nature, it is not possible for the Trust and Priya to make a joint election for the BADR rate to apply to the Trust gains (as it would be in the case of a qualifying holding in an Interest In Possession Trust).

The Trust gains will therefore *not* be eligible for BADR, and will be taxed at 20% (after the CGT annual exempt amount has been applied).

B5 - Priya's intention to purchase commercial property

BPR (for IHT purposes) will be available on the commercial property where:

- It has been owned for more than 2 years, and used in the business for 2 years or more
- Where the owner has a controlling holding of the company

The rate of relief in this case will be 50%.

If Priya passes 5% of her holding to Sunil she will no longer have a controlling holding of the company (as she will be left with a 49% share). This will mean that the commercial property will not be eligible for BPR in future (nor on the proportion of the property that will be owned by Richard as he does not hold shares in the company at all).

B6 - IHT and CGT on distribution from Trust

The shares will qualify for 100% BPR (the company is unincorporated, trading, and the shares have been held for more than 2 years by the Trust), the value of the exit from the Trust will therefore be reduced to £nil for the purpose of calculating the IHT exit charge, and the IHT due will therefore also be £nil.

The availability of BPR is not affected by Sunil's residence position.

The CGT due on the Transfer to Sunil would be £6,770 (Appendix 5).

This would need to be reported on the Trust Tax Return (with CGT payment due by 31 January following the end of the year of transfer).

B7 - IHT and CGT on gift from Priya

There would be no immediate charge to IHT on the gift of shares from Priya to Sunil as the gift would be a PET.

The value of the PET may be reduced by the IHT annual exemption of £3,000, and the previous year's exemption (if available) ie. by up to £6,000.

If Priya were to pass within 7 years of the gift, IHT would become due to the extent that the gift exceeds Priya's available nil band (£325,000 - chargeable lifetime transfers in the 7 years preceeding the gift). The rate of tax on death is 40% (although 'taper relief' is available to reduce this if the donor survives more than 3 years, but less than 7).

In the worst case scenario (but assuming that Priya's nil band and annual exemptions are fully available) this would mean that the potential IHT exposure would be £159,000 (490,000 - 6,000 - 325,000) @ 40% = £63,600.

This would be payable by Sunil as the donee (within 6 months of Priya's death).

Priya could consider taking out a life policy to protect against such exposure (noting Sunil as the beneficiary in the event of her death).

However, all being well, the PET would otherwise become exempt after 7 years and no IHT payable at all.

In terms of CGT, no holdover relief will be available to Priya as

Sunil is non-UK resident, which means that CGT will be payable immediately on the gift (and the previous holdover elections made by Avani and Jayesh will crystallise).

The CGT arising on the transfer would therefore be £49,000 (see Appendix 6). This would be reportable on the self-assessment tax return relating to the year that the transfer is made, with tax due and payable no later than the 31 January following the end of the tax year.

B8 - recommendation for transfer of shares to Sunil

The letter of wishes made by Jayesh noted a preference that while there still remained beneficiaries under the age of 25 (we understand that this is the case as Sunil is about to turn 25 and is the oldest beneficiary) he did not wish for more than 10% of the Trust capital to be distributed.

We do not hold a current valuation of the Company, nor of the Trust's holding.

The proposed distribution to Sunil is more than 10% of the probate value, however the 5% valuation would indicate that the company of as a whole has increase in value since.

The Trustees will therefore need to consider the below in conjunction with a full valuation and in consideration of Jayesh's wishes.

However, from a taxation point of view, a significantly higher liability to CGT (and potential exposure to IHT) will arise if Priya transfer a 5% holding to Sunil from her personal shareholding, as compared with the Trust.

If the Trust makes the distribution, the CGT saving will be £42,230 (£49,000 - £6,770), and trust's liability to IHT (£nil)

compared with the *potential* exposure to IHT of £63,600 should Priya pass within 7 years, is a significant difference.

Furthermore Priya wishes to secure BPR (for IHT purposes) on her share of the proposed investment in the commercial property, she should not dilute her her personal shareholding in Traditional Storage Ltd. to less than 51%.

Should she further wish to maximise eligibility to BPR on the commercial property, her husband Robert should transfer the additional funds to her prior to purchase (such as transfer would be exempt for IHT purposes as it is between spouses), and she should make the purchase in her name so as to secure as much relief as possible.

We therefore recommend, from a taxation perspective, that the gift of shares to Sunil should be made from the Trust.

Chartered Tax Advisers

May 2023

APPENDIX

1 - Initial Value of Trust and actual rate as at September 2023

Avani settled the Trust for her husband's benefit during lifetime (as a QIIP).

Once his interest ceased on his death and the entitlement passed to Priya and Ravi, the property is effectively treated as forming a new settlement made by Jayesh (as he was the last spouse to have an interest in it - s80 IHTA 1984) but with reference to the original date of settlement for the purpose of calculating quarters for the relevant property charges (ie. Avani's death,

being January 2016).

The initial value of the Trust is therefore:

100 shares x £6,100 610,000 *valuation on Jayesh's death*

Actual Rate of Tax calculated as follows:

100 shares x £6,100	610,000	
Nil band	(325,000)	<i>in force for 2023-24 year</i>
less	<u> -</u>	<i>7y prior to death, assumed</i>
none		
	285,000	
Notional tax @ 20%	57,000	

Effective rate = $57,000 / 610,000 \times 100 = 9.344\%$ (3dp)

Complete quarters from Avani's death to proposed exit (September 2023):

January 2016 to September 2023 = 30

Actual Rate = $9.344\% \times 30\% \times 30/40 = 2.102\%$

2 - Gain on shares

On death of Avani, shares will have received an uplift to base cost as they formed part of Jayesh's estate, although this would not have been an occasion to charge to CGT.

Base cost therefore:

100 shares x £6,100 = 610,000

Current market value per valuation:

£735,000

Gain arising on shares:

Market value	735,000
base cost	<u>(610,000)</u>
	125,000

On the Trust = full gain of £125,000

Each beneficiary (if distributed) = 50% x 125,000 = £62,500

3 - IHT on distribution of shares from Trust

Assets leaving Trust (Market value of shares)	735,000
less BPR (100%)	<u>(735,000)</u>
<u>Transfer of value</u>	nil

4 - CGT and IHT on distribution of Cash from Trust

If the shares are first sold in the Trust and the cash distributed to Priya and Ravi instead (say September 2023 as anticipated) the position will be as follows:

CGT arising:

Market value	735,000
base cost	<u>(610,000)</u>
	125,000
Trust AEA	<u>(6,150)</u>
Taxable	118,850
CGT @ 20%	23,770

Cash available for distribution:

Proceeds	735,000
less CGT	<u>(23,770)</u>
	711,230

Exit charge = $711,230 \times 2.102\%$ (Appendix 1) = £14,950

this rate of tax assumes that Priya and Ravi pay the IHT 'personally' rather than in their capacity as Trustees to make use of a lower IHT rate.

Total amount available to Priya and Ravi:

Proceeds	735,000
CGT	(23,770)
IHT	<u>(14,950)</u>
	696,280

Each of Priya and Ravi = $696,280 \times 50\%$ = £348,140

5 - CGT on distribution of shares from Chandra Discretionary Trust

Base cost:

20 shares 1,800,000

5 shares = $5/20 \times 1,800,000$ = £450,000

Gains:

Market value of proposed transfer 490,000

Base cost	<u>(450,000)</u>
Gain	40,000
Trust AEA	<u>(6,150)</u>
Taxable	33,850
CGT @ 20%	6,770

6 - CGT on gift of shares from Priya to Sunil (no holdiver releif available)

Base cost:

	Base cost	Holding
		30
Transfer at 20/05/2012	580,000	
gain held over	<u>(579,970)</u>	
Base cost	30	
		24
Transfer at 16/03/1998	150,000	
gain held over	<u>(149,976)</u>	
Base cost	24	
TOTAL	54	54

Gains:

Market value of proposed transfer	490,000	
Base cost (5/54 x 54)	<u>(5)</u>	
Gain	489,995	
AEA	<u>(-)</u>	<i>none remaining</i>
Taxable	489,995	

CGT @ 10%

49,000