

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

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Event **NA**

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REPORT

To: Mrs Audrey Talbot

From: Chartered Tax Advisers (Fictitium Tax Advisers)

Date: 15 November 2023

Subject: Your Inheritance Tax Planning, trust creation and recommendations

INTRODUCTION

This report is drafted for the attention of Mrs Audrey Talbot.

This report will discuss Mrs A Talbot current position, creation of the trust during the life time and creation of the trust on your death. This report will also discuss administration of the trust.

Also this report will discuss the gifts Mrs Talbot wishes to make to her friends. In addition, this report will provide other options of the tax mitigations during your lifetime or at the date of your death.

No liability is accepted for the reliance on this report by any third party.

We assume that current legislation, rules and tax rates are applied and are constant.

Abbreviation

"You/your" - Mrs Audrey Talbot
"IHT" - Inheritance Tax
"CGT" - Capital Gain Tax
"IT" - Income Tax
"NRB" - Nil Rate Band
"RNRB" - Residential Nil Rate Band
"CLT" - Chargeable Lifetime Transfer
"PET" - Potential Exempt Transfer
"APR" - Agricultural Property Relief

EXECUTIVE SUMMARY

- Based on the current position and assuming you die now the expected inheritance tax liabilities will be around £200,000. There are various relief you lose by creating a will trust on your death and putting the asset into the Will Trust.
- Leaving the Boundary Field will fall into the Will trust on the date of death. The land appreciates in value during 5 years, while agricultural value stays the same. This will increase the total value of the asset on the date of death by £200,000.
- The creation of the lifetime trust will be a Chargeable Lifetime Transfer. This means the creation of the trust will be subject to inheritance tax straight away at the rate of 20% (or 25% if settlor pays). However, two nil rate bands will be available and deducted from the net value after Agricultural Property Relief of £400,000 deducted. Therefore the tax due on creation will be nil.
- There will be capital gain tax liabilities of £72,400 on the

date of the gift of the land to the trust. However, the gift relief will be available and will remove any capital gain liabilities due on the gift to the trust.

- The discretionary trust will be subject to income tax on the rental amount of £8,400 at the rate of 40% (and 20% on the first £1,000). The tax pool will be created and discretionary distributions to grandchildren will carry the tax credit of 45%.

- We recommend to create a trust during the life time, as this will not be chargeable to any inheritance tax due on the date of creation and will not be subject to capital gain tax. The creation will need to be reported to HMRC using the IHT100 form. In addition, it will help to follow your desires as you believe the grandchildren may not be good and responsible with money.

- We recommend to make the cash gift of £65,000 to your friends as soon as possible as a one lump sum (preferably on the same day as your lifetime trust or earlier). This will create a potential life time transfer, but the gift will be fully covered by nil rate band.

- The cash gift will be capital gain free. The funds can also be raised from the sale of stocks and shares ISA - this will be capital gain tax free. It will also help to reduce the total value of the estate. If you survive over 7 years, the gifts will be fully exempt. If you survive only 5 years, the taper relief of 60% will be still available.

- We also recommend to draft the lasting powers of attorney and letter of wishes. The letter of wishes will allow (without redrafting a will) to give the instructions to the executors/trustees to appoint 12 Carnival Way property to a lineal descendant. This means that Residential Nil Rate Band becomes available and you will save up to £70,000.

SECTION A: Review of the current position

Based on the current position and assuming you die now the expected inheritance tax liabilities will be around £200,000. Please refer to appendix A.

You currently has a will, which appoints all asset to the Will trust. This means that all your asset will be subject to IHT at 40% and the executors/trustees will decide, how your residual estate and when is distributed to the beneficiaries: to your grandchildren.

As the will stands you are currently loosing some valuable relief, such as Resident Nil Rate Band. This means that your property 12 Carnival Way can get 100% relief if it falls under some coditions, such as:

- The property is left to a lineal descendant;
- The property was the main residential property.

In additon, the Will Trust will be considered as relevant property trust. This means that if the trustees decide to distribute the asset from the Will trust, they will be liable to IHT at the rate of maximum of 6% (this is called an exit charge).

Also the Will trust will be subject to periodic charges every 10 year at the rate of maximum of 6%.

If any distributions made within first 2 years after the date of death, they are deemed to be made out of Estate and no exit charges are applied.

You currently rely on the other income received, such as pension, ISA. You only accumulate the rental income. Your current Self-

Investment Pension Plan is in drawdown and the total amount is enough to cover the your everyday expenses. You may increase the drawings from the pension to reduce the pension pot.

Below we will provide some recommendations and options, how you can mitigate your total IHT and reduce your assets.

We assume that you may die in 5 years (after October 2028) and we will proceed on this assumption.

SECTION B: Creation of the trust and gifting Boundary Field to a trust

You would wish to sell the site to a developer, as you do not wish to be involved in the development. Also you noted that you do not need the capital and think to transfer Boundary Field (land) to the trust early next year (January - March 2024) for the benefits of your grandchildren.

There are various options to create the trust:

- As you currently has a Will and all your assets are going into will trust, you may leave it as it is; or
- Create a discretionary trust for the benefits of grandchildren now.

(B1) Leaving the land into the Will Trust

If you decide not to do anything and leave current position as it is, the land will fall into your estate. The estimated amount in 5 years will be £1,075,000. As the land is let out to North West

Agriculture Ltd since 29 September 2004, the executors will be entitled to claim Agricultural Property Relief (APR). This is because:

- The land is let out for more over 7 years;
- The land is let for agricultural purposes (growing arable crops, grazing and etc.);
- The tenancy started after 1995, therefore 100% relief is available.

However, the 100% relief will be only available on the agricultural value only. According to the report from the valuation agent, this is £400,000. This amount does not change either in 2023 or 2028. Therefore, the land amount included in your estate in 2028 will be £1,075,000 less £400,000 = £675,000

Assuming the other asset is appreciating and the total value of the estate will be much higher in comparison to it.

From capital gain purposes, the trustees will get the base cost of £1,075,000, which is tax free uplift on the death. If the trustees decide to distribute the asset from the estate, this will be a disposal. Therefore, the benefit of the will trust that the land base cost will be the probate value.

(B2) Creation of the trust during lifetime

You also consider to gift the asset to a trust during the lifetime (early next year).

(B2.1) IHT position

The creation of the trust will be considered as a Chargeable Lifetime Transfer. This means that any amount over NRB will be subject to IHT tax at the rate of 20% (instead of 40% on your death) on the date of transfer. If the settlor pays the tax, the rate will be grossed up and the rate will be 25%.

In addition to, the current value will be "freezed" and will not be changed on your death.

Creation of the trust during the life time will also push the asset out of your estate and will not be included in your death estate.

However, if you do not survive over 7 years, the trustees will need to pay the addition tax at the rate of 40%. The trustees will be able to deduct the earlier tax they paid at 20%/25%.

Based on your current situation, you also has unused David's nil rate band. Therefore, this means that in total your current nil rate band will be £650,000 and this amount can be used against your chargeable life time transfer.

According to Appendix B, if you create a discretionary trust now, the trustees will be able to use your and David's nil rate bands. APR will be available and therefore the total IHT liabilities will be nil.

In case you die in 5 years, you will have a reduced nil rate band balance of £175,000 and the executors will be able to use it against the rest of the asset. This means, the lifetime trust will be fully covered by nil rate band and on the date of death there will not be any additional tax due.

If the trustees wish to sell the property in the future, it means they will lose the APR relief.

(B2.2) Capital Gain Tax

The gift of the land will be considered as a disposal for the capital gain purposes. According to Appendix B, the expected CGT will be approximately £72,400.

However, the gift relief claim will be available. As the gift of the asset will fall under IHT tax on the date of the gift, and even it is fully covered by NRB, the gift relief will still be applied. This means that the gain of £72,400 will not be required to be paid and the trustees will get the base cost of the probate value, which was £500,000.

In future, if the trustees decide to sell the land, they will need to use the original base cost of £500,000 and not the market value, when the trust received the land. The rate of the CGT will be 20%. They will also be able to apply annual exemption amount of £6,150, but this is currently under review by the Government and may be reduced in future.

In addition there will be no any land stamp duty charges, as this is a gift to a trust (non-monetary).

(B2.3) Administration of the trust

Once the trust is created, there will be various administrations.

The trust is required to be registered with the Trust Registration Service within 90 days.

The trust will receive the rental income of £8,400 per annum. A self assessment is required and the trustees will need to submit it. The rental income will be subject to 45% income tax (first £1,000 will be taxable at 20%).

The trustees will be able to accumulate and use the pool rate. This means, any tax paid on the rental income will be accumulated. When the trustees decide to make discretionary distributions, your grandchildren will be able to receive the income distribution with a tax credit of 45%.

It means if some of them are basic tax rate payers (pay tax at 20%). They will be able to claim a repayment for the difference between 20% and 45% paid by the trustees.

Also, we should make you aware, that the trust will be subject to exit charges and periodic charges, as this is a relevant property trust. This was discussed earlier.

The form IHT400 is required to be submitted to HMRC to notify of the creation of the trust along with Trust Registration Service.

We recommend you to contact your solicitor to arrange the trust deed.

RECOMMENDATION

We recommend to create a trust during your lifetime as soon as possible.

This will allow to use your and David's NRB. This will shift out a massive amount from your estate and you will be able to save on IHT on the date of death. This is also because the asset appreciates in value, however the agricultural amount stays the same.

SECTION C: gifts to the friends

You are planning to make to make a gift of £65,000 to various friends.

From IHT purposes the gift made over the annual exemption amount of £3,000 will be considered as a potential exempt transfer. This means that is you do not survive over 7 years, the gifts will fall into your estate. The donees will be required to pay any tax due on the gifted amounts.

However, the taper relief will also available after 3 years of the gift and the inheritance tax due will be reduced by 20% each year after 3 years.

But the IHT will be due if the amounts are only over your NRB.

We recommended to create a trust as soon as possible to transfer the land. You have two nil rate bands. In case you die in 5 years, the estimated balance of the nil rate band left will be £175,000 (Appendix B).

There will be enough left to cover the full amount of £65,000. Meaning the balance left for the estate of £110,000 of unused nil rate band.

We would also recommend to make the cash gift of £65,000 on the same day - this is because will simplify the process and will be possible to keep the tracking of the usage of NRB.

The gift of the cash will not be subject to CGT, as this is exempt asset.

The other option would be to sell some ISA stock and shares. The

transaction will be CGT free and gift the proceeds to the friends. It will also help to keep the actual cash for your regular spending and reduce the value of the ISA in case of your death for the estate.

The other available option will be the regular gifts out of the income. This means that you will not need to pay any IHT and this gifts will not create PET. However, there should be a regular pattern created for the gifts and your usual everyday life should not impacted by these gifts. Assuming you survive 5 years, you will be able to create a regular patters over the next years.

Assuming you transfer the land to the trust, you will loose your rental income. But you have a massive SIPP pot and you may wish to increase the withdrawals from the pension to increase your annual income and cover the gifts out of income.

RECOMMENDATIONS

We recommend to make the cash gift of £65,000 to your friends as soon as possible. The funds can be generated out of the sale of stock and shares. This means you will not be subject to CGT on the sale of ISA and will create the PET transferes, which will be fully covered by NRB.

SECTION D: Other issues and recommendation

(D1) Lasting Power of Attorney (LPA)

You mentioned that you are currently in a good mental and

physical health, but things can change. Therefore, we recommend you to arrange a Lasting Power of Attorney. There are two types of powers:

- financial;
- and health/everyday decisions.

According to the Practice Code, we are not allowed to draft these types of legal documents and therefore, we recommend you to ask your solicitors to assist you with this. We can see that you already appointed Bolton Solicitors LLP as your executors and your trustees. They will be able to arrange LPAs for you.

(D2) Letter of wishes

Along with the Will we would also recommend to arrange a letter of wishes. This will allow the executors and trustees of your Will to help them how you would wish to distribute the asset to the beneficiaries.

In addition, in the letter of wishes, you may consider instruct your trustees/executors to appoint your main residential property 12 Carnival Way to be gifted to your lineal descendant within the first two years (to one of the beneficiary, say who does not have a current property). This will not require to redraft the will and the transfer in the first 2 years to beneficiaries are treated as made out of the estate.

This action will allow to claim an additional Residence Nil Rate Band and also transfer any unused RNRB from your spouse, in case the property appreciated in the value.

Your current RNRB will be £175,000. If extra transferred to from your spouse, this will be in total of £350,000. But this amount

is limited up to the value of the property. Therefore, you will be able to save on IHT up to £70,000 (£175,000 x 40%).

We recommend you to ask your solicitors to assist you with the Letter of Wishes, as we are not allowed to draft legal documents according to the Practice Code.

(D3) Overview

Assume the above recommendations are followed the expected IHT liabilities would be £119,200 (Appendix C). This is a saving of £80,800 in comparison to £200,000.

Fictitium Tax Advisers
15 November 2023

Appendix A

If Audrey dies now

	£	£	
12 Carnival Way		175,000	
Boundary Field	875,000		
Less APR	<u>(400,000)</u>		
		475,000	
Cash in Banks		120,000	
ISA Stocks		380,000	
Pension		0	SIPP not included

Total Gross asset		1,150,000	
Less NRB		(650,000)	
Taxable Estate		500,000	
Tax @ 40%	200,000		

Comments:

- RNRB is not available as the asset goes into Will Trust according to the will.

Appendix B

Tax on the Chargeable Life Time transfer (discretionary trust)

	£	£	
Boundary Field	875,000		
Less APR	<u>(400,000)</u>		
Total		475,000	
Less NRB		(650,000)	
Tax due now @ 20%	0		

CGT position

Proceeds	875,000
Less PV	<u>(500,000)</u>
Gain	375,000
Less AEA	(12,300)
Net gain	362,700
Tax @ 20%	£72,400

Comments:

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- Audrey has available two nil rate bands, as it can be transferred from her spouse David
 - Balance of NRB remaining for the estate left: £650,000 less £475,000 = £175,000
 - The trustees will not need to pay IHT.

Appendix C

If Audrey dies after 5 years

	£	£	
12 Carnival Way (1)		0	Comment 1
Cash in Bank (2)		55,000	Comment 2
Investment (3)		<u>418,000</u>	Comment 3
Total asset		473,000	
Less NRB remaining		(175,000)	
Net asset		298,000	
Tax due at 40%	119,200		

1. Assume RNRB is claimed and asset is distributed to beneficiaries within 2 years
2. Assume the gift to friends of £65,000 was made. Balance left £120,000 less £65,000 = £55,000
3. Assume the investment appreciate in value by 10%.

Notes:

- The trustees will not need to pay IHT on the trust's asset, as this will be fully covered by NRB.