

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

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Answer-to-Question-_1_

To: The trustees of the Lucy Reed Will Trust

From: Chartered Tax Advisors

Date: 15 May 2024

Subject: Inheritance Tax queries

Introduction

This report is prepared in response to the email received on 30th April 2024.

It contains advise regarding the taxation issues of the trustees of the Lucy Reed will trust.

The report is created solely for the trustees of the Lucy Reed will trust and we bear no responsibility for any reliance place on it by a third party.

The information contained in the report is as per the valuations provided by the trustees and is current as per the prevailing tax laws.

Executive Summary

- The Lucy Reed will trust was created on 15th June 2022 at the ocassion of death of Mrs. Lucy for the benefit of her children and future grandchildren.It is a discretionary will trust and therefore follows the relevant property regime.

- We recommend to apply for a refund for the extra IHT paid in

terms of the Honey Group plc shares amounting to £10,800. The shares were sold within a year of death of Mrs. Lucy therefore post mortem relief is available. This will result in extra cash being available to fund Jessica's fees.

- It is recommended that the Lavendar Cottage is assigned to Jessica before 15th June 2024 and then she sells the cottage and keeps the proceeds to fund her tuition fees payment. This will avoid an IHT charge and thereby save £1,116. However, when there is cash distribution to fund the balancing figure of £16,200 an IHT exit charge of £205 will arise. Therefore, the net tax saving with this option is £911.

- The refund for IHT can be applied immediately it is recommended that the net shortfall for £16,200 be paid from the cash held in the current account. The major expenses for Avenue House have already been paid so whenever the refund comes in the current account balance can be topped again. If it is done before 15th June 2024, it will avoid the IHT charge of £205 and result in zero tax payable on the transaction recommended in Section C.

- It is recommended to wait till the meetings have taken place to assign shares to Charlotte as this will result in a net tax savings of £24,271 to the trust. This is because after 15th June 2024 the trust becomes liable to exit charges and therefore gift relief becomes available to defer the gains incurring on the transfer of unquoted shares of Floral.

The current trading status of Floral means that gift relief will be denied if the shares are transferred right now.

- Gift relief claim would need to be filed within 4 years of

making the transfer to Charlotte and would need her consent.

Report to the Trustees of the Lucy Reed will Trust

Section A - Overview of the Trust

The Lucy Reed will trust was created on 15th June 2022 at the occasion of death of Mrs. Lucy for the benefit of her children and future grandchildren.

It is a discretionary will trust and therefore follows the relevant property regime.

This means that for inheritance tax (IHT) purposes it will be liable to exit charges whenever there is a capital distribution to its beneficiaries. However, any distribution made to a beneficiary within the first 2 years of the making of this trust will be exempt from an exit charge.

It will also be liable to a principal charge on every 10th anniversary of the creation of the trust. The first charge will be incurred on 15th June 2032.

For capital gains tax (CGT) purposes, the trust will be taxed on

it's chargeable gains at a rate of 20% for non residential gains and 28% for residential gains. These are the rates that are applicable to trusts. The trust will benefit from an annual exemption of £3,000.

In terms of income tax (IT), the trust will pay income tax at the rate of 45% for Savings and Non savings income and 39.35% for dividend income. However, the first £1,000 of Non savings trust income will be charged at the basic rate of 20%. Income distributions made to the beneficiaries will be net of these taxes and they would be provided with an R185 form detailing the same.

Any trust management expenses are allowable for deduction from the trust income.

Section B - Sale of Honey Group plc Shares

The forced sale of Honey group shares in May 2023 created a capital loss of £27,000. This can result in an IHT repayment of £10,800 for the trustees (Appendix 1).

As the disposal of shares took place within the first year of death of Mrs. Lucy and it was during the administration period of the estate, Post mortem relief is available.

Post mortem relief allows the administrators to seek IHT repayment for assets sold at a loss as compared with their probate value at death.

In this case, the time limit for sale of shares was 12 months i.

e. Before June 2023, from death and as that condition is satisfied the trustees can now apply for a refund to HMRC for £10,800.

The sale has not been reported to HMRC yet and therefore should be done as soon as possible as it was due to be reported by January 2024.

Recommendation

We recommend to apply for a refund for the extra IHT paid in terms of the Honey Group plc shares amounting to £10,800. The shares were sold within a year of death of Mrs. Lucy therefore post mortem relief is available.

This will result in extra cash being available to fund Jessica's fees.

The sale has not been reported to HMRC yet and therefore should be done as soon as possible as it was due to be reported by January 2024.

Section C - Sale of Lavendar Cottage

Section C - 1 Sell in trust then distribute cash to Jessica after 15th Sep 2024

IHT

If the trust decide to sell Lavendar cottage and then distribute cash to Jessica after 15th Sep 2024 it will result in an IHT £1,116 (Appendix 2).

As the completed quarters would have been 9 since the creation of trust the effective tax rate would be 1.24% which would be applicable on the distribution of cash to Jessica.

CGT

For CGT purposes, there will be no CGT payable by the trust, This is due to the fact that one of the beneficiaries i.e Charlotte was allowed to live in the house as her main residence for some time.

As the cottage was being used as the primary residence of Charlotte the disposal will qualify for the principal residence relief (PRR) and therefore all the Gain of £13,800 will be exempt

There are no CGT consequences of cash distributions as they are exempt.

Section C - 2 Assign Asset to Jessica and then she sells

IHT

If the cottage is assigned to Jessica right now before 15 June 2024, there will be no IHT payable by the trustees on the distribution as it is within 2 years of the creation of the will trust.

For distributions being made within 2 years of creation of the will trust, it is assumed that the distributions are made

directly from the will therefore carry no IHT exit charges.

However, the extra cash needed to cover the £90,000 will have to be made available to Jessica before October 2024 and therefore a further net distribution of £16,200 will be required to be made.

(Appendix 3)

Assuming this is made after 15th Sep 2024, the exit charge associated with this distribution will be £205.

CGT

For CGT purposes, there will be no CGT payable by the trust, even though the assignment to Jessica will be considered a disposal at market value.

This is due to the availability of PRR same as in Section C - 1.

Once the asset is with Jessica and then she sells the cottage there will not be any gain for her as the probate value would have been the same as market value at the time of her disposal.

Recommendation

It is recommended that the Lavendar Cottage is assigned to Jessica before 15th June 2024 and then she sells the cottage and keeps the proceeds to fund her tuition fees payment.

This will avoid an IHT charges and thereby save £1,116.

However, when there is a cash distribution to fund the balancing figure of £16,200 an IHT exit charge of £205 will arise.

Therefore, the net tax saving with this option is £911.

In terms of CGT, PRR is available to the trust therefore no tax is payable .

Section D - Consequent Funding of Jessica's Fees

After the trust has applied for the Refund mentioned in Section B (£10,800) and Assigned the house (£73,800) in Section C the shortfall for Jessica's funds would only be £5,400. If the refund comes before the 2 year anniversary of the trust then only £5,400 will need to be paid otherwise £16,200.

Recommendation

As the refund for IHT can be applied immediately it is recommended that the net shortfall for £16,200 be paid from the cash held in the current account. The major expenses for Avenue House have already been paid so whenever the refund comes in the current account balance can be topped again.

If it is done before 15th June 2024, it will avoid the IHT charge of £205 and result in zero tax payable on the transaction recommended in Section C.

Section E - Assignment of Shares to Charlotte

Section E - 1 - Assign 250 shares to Charlotte Now

IHT

The shares held in Floral Limited (Floral) currently will carry no IHT exit charge as they qualify for 100% Business property relief (BPR) in addition to the proposed transfer taking place within 2 years of the creation of trust which also ensure no IHT on exit charge.

In order for shares to qualify for BPR:

1. The shares must be of a qualify trading unquoted company;
2. Must have been held for a minimum of 2 years.

Let us look at each condition in turn.

To determine the trading status of Floral for IHT purposes the company needs to be mainly trading. Mainly trading means that more than 50% of the activities that the business conducts must be trading.

As we can see in Appendix 4 the test will be passed as the company has more than 50% of its turnover, profits and staff deriving their value from the trading side of the business.

The second thing to look at is if the BPR would be restricted if the company held any excepted assets. Looking at the balance sheet there are no excepted assets as the investment properties are used in the main business and the cash reserves are less than 25% of the turnover.

In terms of the second condition although it has not been two years since the trust has held the property but the successive transfer rules will apply here which allow for BPR to be made

available if BPR was available on the previous transfer and if either of the transfers took place at death.

CGT

For CGT purposes, a liability of £29,150 will arise (Appendix 4).

There is no possibility of gift relief as there is no exit charge in the first 2 years of a capital distribution from a discretionary will trust.

The other option to reduce the CGT liability would have been to use the gift relief under trading section but it seems that the business as it currently stands will not qualify as a trading business for CGT purposes.

In order to qualify as a trade for CGT purposes the business must not have more than 20% of it's activites dedicated to the non trade side.

Currently, the value of the assets, profit and turnover are all above the 20% threshold and therefore it is highly likely that no CGT relief will be allowed.

Section E - 2 Assign 250 shares to Charlotte after negotiations

IHT

An IHT exit charge of £4,879 (Appendix 5) will arise of the shares are assigned to Charlotte after finalzing the deal.

Although the shares currently qualify for 100% BPR, if the

negotiations are concluded in September 2024 this would mean that a deal has been made to sell the company.

BPR is denied when the contracts to sell are already in place, therefore if the trust assigns the shares to Charlotte after the deal is made there will be an IHT exit charge.

In the unlikely scenario that the deal falls through then 100% BPR would still be available resulting in zero IHT payable on exit.

CGT

For CGT purposes, there will be no CGT payable by the trust as relief will be available under section 260 which allows gains to be deferred if the distribution carries an IHT charge.

It is pertinent to note, that even if the deal is not concluded, the relief will still be available after 15th September 2024 as although there will not be any exit charge payable due to availability of BPR, gift relief rules allow for gains to be deferred if there would have been an IHT charge in absence of BPR.

This will allow for the base cost of the shares to be transferred to Charlotte be £1.6m, the same as the probate value on death of Mrs. Lucy. (Appendix 5).

The claim for gift relief will need to be filed within 4 years of making the gift and would require consent of both Charlotte and the trustees.

If the deal is finalized in September 2024 and assuming the same M.V prevails the CGT payable by Charlotte would be £28,550.

(Appendix 6)

Recommendation

It is recommended to wait till the meetings have taken place to assign shares to Charlotte as this will result in a net tax savings of £24,271 to the trust.

This is because after 15th June 2024 the trust becomes liable to exit charges and therefore gift relief becomes available to defer the gains incurring on the transfer of unquoted shares of Floral. The current trading status of Floral means that gift relief will be denied if the shares are transferred right now.

Gift relief claim would need to be filed within 4 years of making the transfer to Charlotte and would need her consent.

If you have any queries regarding the report please do not hesitate to contact us.

Chartered Tax Advisors

Appendix 1 - Sale of Honey Group plc shares

M.V at sale	43,200				
Probate Value at death	70,200				
Loss on sale	(27,000)				
IHT repayment at 40% Post mortem relief	10,800				

Appendix 2 - Option 1 - Sale of Lavendar Cottage by Trustees then distribute after Sep 2024

CGT - Sale of Lavendar Cottage

M.V	75,000				
Cost of selling	(1,200)				
Probate value	(60,000)				
Chargeable gain	13,800				
Covered by principal residence relief	(13,800)				

Distribution post Sep 2024

No CGT on cash

IHT on distribution

Completed quarters would be 9/40

Initial value of trust	3,931,635				
NRB	(325,000)				
	3,606,635				
Notional IHT at 20%	721,327				
Effective Rate	18.35%				
18.35% x 30% x 9/40	1.24%				
1.24% x 90,000	1,116				

Appendix 3 - Option 2 Assign Lavendar Cottage to Jessica and then she sells

Assign cottage to Jessica
 IHT - None as within first two years of death

CGT - As above covered by PRR

Jessica Sells
 CGT - Nil as base cost same as M.V

Distribution by trust to Jessica to fulfill 90K

Effective Rate x 30%9/40	1.24%				
16,500 x 1.24%	205				

Total Tax Implication = 205

Appendix 4 - Transfer of shares to Charlotte - Option 1 - Assign Shares Now - May 2024

IHT - Within 2 years of death resulting in no IHT

CGT

M.V	1,748,750				
Probate value	(1,600,000)				
Gain	148,750				
A.E	(3,000)				
Chargeable gain	145,750				
CGT at 20%	29,150				

Trading test of Floral - Failed for CGT

	Trading	Non trading	Non trading %age		
Turnover	2,130,000	659,000	23.63%		
Profit	1,152,000	496,000	30.1%		
Staff	12	0	Zero		
Assets	2,100,000	3,400,000	61.82%		

Appendix 5 - Transfer of shares to Charlotte - Option 2 - Assign shares after deal is concluded Post Sep 2024

IHT - BPR will be denied as contract/sale agreed - exit charge will take place

Effective rate	1.24%				
1.24% x 9/40 X 1,748,750	4,879				

CGT - Gift relief will be available under s260 - as exit charge is incurred - Probate value will be - 1,600,000 for 250 shares

Appendix 6 - Sale of Shares by Charlotte

M.V	1,748,750				
Cost	1,600,000				
Gain	148,750				
A.E	(6,000)				
CG	142,750				
CGT at 20%	28,550				