The Chartered Institute of Taxation

Application and Professional Skills

Inheritance Tax, Trusts & Estates

May 2026

Suggested answer

<u>Report to Jean Mary Macfarlane</u>

This report is prepared for Jean Macfarlane ("you") and may not be relied on by any other person or entity without our prior written consent. The report covers:

1. Your Inheritance Tax ("IHT") exposure, including relevant reliefs.

2. The tax implications of you living with either Emma or James and our recommendation for your living arrangements.

3. The proposed gift of 3A Turney Road to James and our recommendations in relation to the structure of that gift.

4. The terms of your current Will and our proposed amendments.

Our advice is based on the information held on our file and the legislation in force at today's date. A delay in implementing our recommendations, a significant fiscal event or a change to your personal or financial circumstances may affect this advice.

1. Executive summary

Your estate's current IHT exposure (before any gifts are made) is £360,400 (**see Appendix).** Your estate's IHT liability will be approximately £218,000 if the steps recommended in this report are taken.

<u>Living arrangements</u>

From an Income Tax perspective, it would be preferable for you to live with James. If you move in with Emma, you will become liable to pre-owned asset tax ("POAT"), with an annual charge in the region of £19,200 (based on the suggested rental value of Emma's property). This is because you have contributed towards the purchase of Emma's home within the last seven years. There will be no liability to POAT if you live with James because the gift of £30,000 you intend to make to him prior to moving in is unlikely to qualify as an "acquisition of land" for the purposes of the POAT rules, as the renovations are to existing property and are not extending the property in any way.

<u>Gift of 3A Turney Road to James</u>

If you hold the majority shareholding in Castle Galleries Ltd until death, we recommend that 3A Turney Road is also retained until death and gifted to James as a legacy in your Will. Firstly, you will make a considerable saving due to the Capital Gains Tax ("CGT") uplift on death, saving you or James in the region of £102,000 in CGT. Secondly, there are likely to be adverse IHT implications of a lifetime transfer, as you are not expected to survive the next seven years. Business Property Relief ("BPR") available on the potentially exempt transfer ("PET") to James will be withdrawn on your death as the property will not qualify for BPR in his hands and this will increase the IHT liability (borne by James) by £110,000.

<u>Amending the gifts for your grandchildren in your Will</u>

We recommend that your Will is amended to give each of your grandchildren an immediate post-death interest ("IPDI"), giving them an entitlement to the income from their respective share of the capital. This will enable your estate to benefit from the Residence Nil Rate Band ("RNRB") while also ensuring that the capital is retained in trust until each grandchild is ready to receive it. In addition, an IPDI would simplify the Income Tax position and avoid charges to IHT while the assets remain in trust. If you are uncomfortable with your grandchildren having an entitlement to income, a discretionary trust could be used instead, which could give the same tax benefits if the trusts were altered appropriately within two years of your death.

2. Current situation

At the date of this report your assets total £1,921,000 **(see Appendix).**

Your estate will benefit from your Nil Rate Band ("NRB") of £325,000, but no transferrable NRB from your husband's estate as it was fully used on his death. There will be no RNRB available to your estate unless further steps are taken.

The shares in Castle Galleries Ltd are likely to qualify for 100% BPR as:

- The company is an unquoted trading company, and its trade does not fall within certain 'investment' activities.
- You have owned the shares for at least two years.
- The company does not hold any "excepted assets" i.e. assets that are neither used for business purposes throughout the previous two years nor required for future use in the business.

3A Turney Road will qualify for BPR at a rate of 50% assuming you have voting control of Castle Galleries Ltd by virtue of your 60% shareholding. This is because 3A Turney Road is used by the company in its trading business. **[IHTTE-IHT 7.2 – 7.5 and 7.7]**

After provision for the available tax reliefs, your current IHT exposure is £360,400 **(see Appendix)**.

3. Living arrangements

<u>Living with Emma</u>

If you move in with Emma any time before August 2027, you will attract an Income Tax charge under the POAT rules.

The POAT rules impose a tax charge on individuals with respect to benefits they receive as a former owner of property, or property derived from that property. The charge can apply to land where a taxpayer occupies land and contributed, directly or indirectly, to the purchase of the relevant property, otherwise than by an "excluded transaction". Where the contribution is a gift of money, it will be an excluded transaction where it was made at least seven years before the donor benefits. You provided part of the consideration for Emma's house purchase when you transferred her £500,000 on 3 August 2020, which will be within seven years of your proposed occupation. **[IHTTE-IHT 20.2 – 20.4]**

The POAT charge will be based on the rental value of the property provided this exceeds £5,000 per year. The charge will be apportioned to reflect the Emma's contribution to the purchase price. If the monthly rental value of the property is in the region of £12,000, with £4,000 of that being apportioned to you (£500,000/£1.5 million purchase price), the annual POAT liability would be in the region of (£4,000 x 12) x 40% = £19,200 (assuming the additional notional £48,000 of income does not take you into the 45% marginal rate). Living with Emma for two years would result in total Income Tax charges of approximately £38,400. This will reduce your available cash across your bank accounts. **[IHTTE-IHT 20.2 – 20.4]**

Where the POAT charge applies, it is possible to make an election for the share of the property representing the gift of cash to be treated as a 'gift with reservation of benefit', so that a one-third share of the property (based on the proportionate market value at the date of your death) forms part of your estate for IHT purposes. This would be a minimum of £500,000 x 40% = £200,000 IHT based on the original cost, so is much less desirable than the POAT charge. **[IHTTE-IHT 20.7]**

<u>Living with James</u>

If you live with James, it is unlikely that you will be subject to POAT, as consideration must be provided for an "acquisition of land" rather than enhancements. A bathroom or other improvements falling short of a self-contained dwelling will not attract a POAT charge.

The cash gift to James will be a PET of £24,000 assuming two annual exemptions are available. If you die within seven years of the gift, the PET will reduce the NRB available on your death or become chargeable to IHT to the extent that it exceeds the available NRB. If you die in two years' time, the August 2020 cash gift of £500,000 to Emma will be outside of the seven-year window, which means that this cash gift to James, if made before any others, will reduce your nil rate band to £301,000, and our IHT calculations are made on that basis. However, if you die before 3 August 2027, the gift to Emma will use up your NRB and the balance will become chargeable to IHT, with no NRB to cover any other lifetime gifts or your death estate. This would increase your estate's IHT liability by £130,000 (£325,000 @ 40%).

Recommendation

We recommend that you move in with James to avoid a POAT charge. The gift of £30,000 will benefit from two annual exemptions and, if you die on or after 3 August 2027, it will be fully covered by your NRB on death. The gift could move some IHT liability to James in the event of your death (up to £9,600). You may therefore wish to provide in your Will that any IHT liability on lifetime gifts will be paid from your estate. This would also benefit Emma as the £500,000 cash gift to her on 3 August 2020 would incur an IHT liability of £169,000 (£500,000 - £6,000 - £325,000) x 40% = £67,600 x 20% = £13,520 if you died on or after 3 August 2026 and £67,600 x 40% = £27,040 if you died before 3 August 2026.

4. Transfer of 3A Turney Road to James

You would like to give this property to James and are not sure whether the timing or structuring of this gift will impact your tax position.

Lifetime transfer to James

A transfer of the property would be a PET for IHT purposes. As the property is currently used by Castle Galleries Ltd, which is an unquoted trading company controlled by you, it will benefit from BPR at a rate of 50%. This will reduce the PET to £275,000, assuming that it is made in the same tax year but after the cash gift to James, so no annual exemptions are available.

As we are working on the assumption you will not outlive the gift within seven years, the PET will become chargeable and the BPR will be reassessed. As James is not a controlling shareholder of Castle Galleries Ltd, BPR will be withdrawn with an additional £99,600 payable by James ((£550,000 + £24,000 - £325,000) x 40%) and an additional £10,400 payable by your estate ((£301,000 - £275,000) x 40%). Therefore overall, this will result in an additional £110,000 of IHT payable on your death. **[IHTTE-IHT 10.2]**

The gift to James will be a disposal for CGT purposes. Based on the current valuation, the gain would be £425,000 (£550,000 - £125,000), with a CGT rate of 24% resulting in £102,000 payable by 31 January 2028.

As the property is an asset used in a trading company of which you own at least a 5% share, holdover relief will be available. If a claim is made, there would be no immediate CGT, and James would receive the property with your base cost of £125,000. A joint election between you and James would need to be made within four years from the end of the tax year of disposal (on or before 5 April 2031). If holdover relief is claimed and James sells the property shortly after your death, he is likely to incur a similar CGT liability to you (subject to any change in value from now) as a higher rate taxpayer. **[IHTTE-IT CGT 23.3]**

Gift to James on your death

50% BPR would be available if the property passes to James on your death. The IHT attributable to the property would be £110,000 based on current values. This will result in £218,000 of IHT overall if the other recommendations in this report are implemented, which is £110,000 less than if the property passes to James in your lifetime resulting in a clawback of BPR.

The gift on your death will result in an uplift in the base cost of the property for CGT to its market value at that time. Assuming James sells soon after your death this would save at least £102,000 of CGT.

Recommendation

We recommend making a specific gift of 3A Turney Road to James in your Will, which is likely to save £212,000 in IHT and CGT combined. On your death some of the IHT will be attributable to the legacy to James, and this will be payable by the residuary estate unless the Will states that the gift will bear its own tax. **[IHTTE-IHT 25.2]** If the IHT is borne by James, he will need to pay the tax from his own funds, or the property will need to be sold to pay the IHT. An election can be made to pay the IHT in 10 annual instalments, with the first payment due six months from the end of the month of your death.

You may prefer for the gift in the Will to be free of tax, with your grandchildren bearing the IHT as residuary beneficiaries. The possibility of the above-mentioned PETs to Emma and James becoming chargeable to IHT on your death will need to be considered and your Will could state that all lifetime tax is also paid from your residuary estate.

5. Review of your Will

Each of your grandchildren will become entitled to an equal share of the residuary estate at the age of 25, and until then your executors and trustees have powers to pay income and capital to them or use it for their benefit.

As your Will provides for ongoing trusts, your executors and trustees may need to register certain information with HMRC's Trust Registration Service. They should seek further advice about this on your death.

Tax treatment of the ongoing trusts for your grandchildren

IHT and CGT

Your grandchildren are all likely to be under the age of 25 at your death (Cordelia, the oldest, is currently aged 18). Assuming that is the case, each of their shares will be held on a Relevant Property Trust ("RPT") for IHT purposes. **[IHTTE-TE 11.3]** This type of trust is subject to IHT charges every 10 years and when assets leave the trust, up to a maximum of 6% (for 10-year charges) or 5.85% (for exit charges) of the value of the assets on each event. When your grandchildren become entitled to the assets at the age of 25 there will be an exit charge. There would be no IHT charge if any of your grandchildren died before fulfilling the age-contingency as they are not considered to be beneficially entitled to the funds for IHT purposes while held on the RPT.

The trustees will be liable to pay CGT at 24% on gains arising on disposals of assets within the trust. There may also be a CGT disposal when assets leave the trust, but holdover relief may be available where that disposal is also chargeable to IHT.

Income tax

The trustees will be taxed at 45% on non-savings and saving income and 39.35% on dividend income. Where your grandchildren receive income at the trustees' discretion they will be taxed at their marginal rates and where their marginal rates are less than 45%, they can reclaim some or all the tax paid by the trustees.

Entitlement to the RNRB

Your estate is currently within the threshold for RNRB eligibility, although you should continue to monitor this and where practicable aim for the net value before relief (such as BPR) to remain below £2 million.

Although you do not own a qualifying residence, as you sold your residence after 7 July 2015, you will have a ‘downsizing’ allowance. As your home sold for more than the RNRB available at the time (£125,000), there will be 100% of the current RNRB (£175,000) available to your estate. As your husband died before the RNRB was introduced, your estate can also benefit from his unused RNRB to give a total allowance of £350,000.

If your Will is left unamended, your estate will not benefit from the RNRB or transferable RNRB unless further action is taken after your death. This is because your Will contains gifts to your grandchildren contingent on them reaching the age of 25 with no entitlement to income before that age. **[IHTTE-IHT 13.4]**

To make use of the RNRB after your death, your executors and trustees could use the statutory power of advancement to either appoint assets to your grandchildren absolutely or onto a life interest trust, which would qualify as an IPDI, both within two years. **[IHTTE-TE 8.1]**

<u>Alternative options for your Will: IPDI or discretionary trusts</u>

IPDIs for your grandchildren would qualify for the RNRB allowance without post-death action required. Your grandchildren would be treated as entitled to the capital for IHT purposes, therefore avoiding trust IHT charges. However, when they become absolutely entitled to the capital there will be a disposal for CGT purposes, with no ability to hold over the gain unless the property qualifies as ‘business assets’ for the purpose of holdover relief. If any grandchild were to die while the funds were held in trust, the value of their share would be aggregated with their estate and subject to IHT on their death.

The trustees will be subject to Income Tax at 8.75% on dividend income and at 20% on non-savings and savings income. The grandchildren are taxable on the income but can use their personal savings and dividend allowances and could be entitled to some of the tax paid by the trustees where the trust income falls within their personal allowance.

<u>Discretionary trust</u>

A discretionary trust could be included instead with your grandchildren as potential beneficiaries. They would have no entitlement to receive assets at a certain time which would give maximum flexibility but still enable your trustees to appoint the assets absolutely or on IPDI trusts within two years, to benefit from the RNRB and transferable RNRB. The trust would be an RPT so there would be IHT charges unless the trusts were altered within two years of your death. The trustees would be subject to the Income Tax rates applicable to trusts, at 45% for non-savings income and savings income or 39.35% for dividends in the interim.

<u>Recommendation</u>

We recommend that your Will is amended to give the grandchildren a right to the income. This will make the estate administration post-death more straightforward and give immediate entitlement to the RNRB and transferable RNRB. The IHT treatment of the interests as IPDIs is preferable to RPT charges and the Income Tax treatment of the ongoing trusts will be simpler. If the trust income were to be mandated to the beneficiaries, it would negate the requirement to complete an annual trust return with the income being assessable directly on your grandchildren.

The availability of the RNRB will need to be balanced against the grandchildren having an entitlement to the income. If this is not acceptable to you then the current age-contingent gifts or a discretionary trust (with further immediate protection beyond the age of 25) may be more appropriate. A solicitor should be instructed to redraft the Will to include the legacy to James, amend the residuary gifts for the grandchildren and deal appropriately with the burden of IHT in relation to the legacy and any failed PETs.

APPENDIX - Summary of estate and IHT exposure

	Current estate		Proposed estate	
Land and Property	£	£	£	£
3A Turney Road, Tunbridge Wells, TN3 4AH	550,000		550,000	
1B Meadow Hill Road, TN1 4NB	250,000		250,000	
		800,000		800,000
Bank accounts				
UK current account	23,000		23,000	
UK savings account	178,000		148,000 *	
		201,000		171,000
Shares and securities				
60 ordinary £1 shares in Castle Galleries Ltd	420,000		420,000	
Stocks and shares main account	430,000		430,000	
Stocks and shares ISA account	70,000		70,000	
		920,000		920,000
Total assets		1,921,000		1,891,000
Available reliefs				
BPR	695,000		695,000	
NRB	325,000		301,000 **	
RNRB	Nil		350,000 ***	
		(1,020,000)		(1,346,000)
Taxable estate		£901,000		£545,000
Tax at 40%		**£360,400**		**£218,000**

Notes

* Proposed gift to James for renovations of £30,000.

** Reduced by £24,000 to account for the proposed PET of cash to James.

*** RNRB and transferable RNRB would be available due to assets either passing to grandchildren absolutely following appointment from the flexible Will Trust within two years of death (under s.144 IHTA 1984) or onto qualifying interest in possession trusts.