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

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Exam ID

Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**3448**	**16406**	**19722**
Total	**3448**	**16406**	**19722**

Answer-to-Question-_1_

Report to the Trustees of the Susan Wood Will Trust:

To: Trustees of the Susan Wood Will Trust

From: Tax Advisers LLP

Date: 14 November 2024

Subject: Proposed restructuring and distributions from the trust

Introduction

This report is prepared in response to Paul's email dated 10 November 2024 and based on the law as at 14 November 2024.

This report is prepared solely for the trustees of the Susan Wood Will trust. Tax Advisers LLP (we) accepts no responsibility for any reliance placed on this report by other parties.

This report is based on the valuations provided by the trustees of the Susan Wood Will Trust and details Tax Advisers LLP has on file. If there are any changes to the valuations, then please inform Tax Advisers LLP.

The purpose of this report is to advise on the tax implications and provide recommendation on distributing either Beach Farm or Fairview to Shaun, and whether Sunnyside should be distributed to Paul outright now or retain it in the life interest trust.

Executive Summary

Susan had left a letter of wishes setting out her expectations on how the Trust should be distributed, so Tax Advisers LLP's recommendations in this report are aligned to this.

It is recommended that from a tax perspective it is better to distribue Beach Farm, as the trustees and Shaun can claim holdover relief to negate any capital gains tax liability.

The distribution of both assets would result in a potential exempt transfer for inhertiance tax purposes, but if the farming activities continue and Shaun retains the assets for at least 7 years following the gift to him, this will massively reduce any future inheritance tax liability as agricultural property releif will bne retained on Paul's death. This will save the trust £309,400 in capital gains tax liability.

It is also recommended that the trust distributes Sunnyside to Paul outright now. This is because from an inheritance tax perspective, this is inheritance tax neutral, so there is no further liability.

Additionally, Paul will be to reduce his inheritance tax liability by £140k by utilising his Residence nill rate band and transferable residence nil rate band. Paul will also be able to maximise the additional Nil Rate Band and transferable nil rate band available on his death.

As Private residence relief can be claimed by the trustees, the distribution of Sunnyside will also be capital gains tax exempt.

It is also recommended that Paul considers reducing his inheritance liability further, such that it reduces his liability on his death estate. This can involve making £3,000 inheritance free gifts every year to utilise his annual exemptions, making income distributions from excess trust income, making small gifts of up to £250 per person per tax year, and gifts of any potential marriages.

Section A - Trust Background

Prior to looking at the tax implications of each of the relevant proposed distributions, it is useful to initially understand the background of the trust, as this will define the subsequent taxation.

On Susan's death, she left the residue of her estate to a life interest trust/Interest in possession ("IIP") trust. Paul was left as the life tenant of this trust, and has subsequently been receiving income from the trust on an annual basis.

As the trust was created on Susan's death, Pail has an immediate post death interest ("IPDI") in the trust. This is considered a qualifying interest in possession trust ("QIIP"), and it means that the trust assets falls part of Paul's death estate and is chargeable to inheritance tax ("IHT") on his death.

Following Paul's death, the trust becomes a discretionary trust for the benefit of the

discretionary beneficiaries. The trust becomes a relevant property trust ("RPT") at this stage.

The consequences of the trust becoming a RPT is that it becomes liable to exit charges on distributions out of the trust, and becomes liable to principle charges (IHT charges) on the trust value on every 10 year anniversary.

As the trust was initially a QIIP and becomes a RPT (following Paul's death), there are tax specific rules in place which define the IHT rules.

The rules are that Paul is deemed to be the settlor of the trust for IHT purposes. This means that his cumulative clock (chargeable transfers in the 7 years prior to his death/creation of the RPT) is assessed on any exit and principle charges on distributions out of the trust.

However, the principle charges continue from every 10 year anniversary from Susan's death. The first 10 year anniversary was 2022, but as the trust was not a RPT, there were no principle charges.

Exit charges will be charged on any distributions out of the trust, based on the value distriubuted multiplied by a percentage that is dependent on a number of factors, including the number of quarters between the exit distribution and when the trust converts to a RPT.

Although, the above exit and principle charges are not directly relevant to the distributions on the proposed transfers detailed in this report, it may become relevant on distributions following Paul's death, specifically potentially to Rachel if distributions are preferred to be kept in the discretionary trust, such that the trustees can make an informed

decision on distributions to her.

Section B - Distribution of either Beach Farm or Fairview to Shaun

Following conversations with Paul and Claire, advice was requested regarding distributing either Fairview or Beach Farm from the trust to Shaun on his 30th birthday in February 2025.

During Paul's lifetime, as the trust assets sit in Paul's estate for IHT, trust Distributions from the trust during Paul's lifetime to Shaun will be a considered a potentially exempt transfer ("PET") for IHT purposes for Paul.

This means there will be no immediate charge to IHT on distribution of either asset to Shaun. Additionally, if Paul was to survive 7 years from the distribution, this gift would be deemed to be exempt from IHT.

If Paul was to die within 7 years of distribution of either asset, IHT would be liable on death. The transfer would use Paul's nil rate band (NRB) in priority, which is £325,000 of IHT charged at 0%. Any excess over the NRB would be chargeable to IHT on the donee (in this case Shaun) at 40%.

Taper relief would be available to reduce any future IHT liability if Paul survives between 3 and 7 years from distribution.

Any distribution from a capital gains tax (CGT) perspective will be deemed to be a market value distribution, and hence CGT liability may arise for the trustees.

(B1) Distribution of Fairview to Shaun

If Fairview was distributed to Shaun, there will be associated IHT and CGT implications.

IHT

From an IHT perspective, as mentioned above, this will be deemed to be a distribution from Paul to Shaun, and will be a PET. The PET will be adjudged on a loss to donor basis, so in this case, it will be based on the market value of Fairview of £4.3m.

There will be no immediate charge to IHT and if Shaun is to live 7 years, the gift will be exempt from IHT.

If Paul was to die within 3 years, the £4.3m would be entirely chargeable to IHT (potentially charged to IHT at up to 40%, less any NRB available, so up to 1.72m). Shaun would need to pay the IHT liability. Tapering relief would reduce the IHT liability if Paul surivives betweeen 3 and 7 years.

Given the size of the potential IHT liability, it may be best to take life assurance on Paul's life. There does not appear to be any health issues currently with Paul, so the cost of the premiums may be reasonable.

CGT

From a CGT perspective, the distributions from the trust will be deemed to be at market value. The base cost for CGT purposes will be the probate value at Susan's death.

This means a CGT liability will arise of £309,400 as per Apppendix 1.

As the distribution is not immediately chargeable to IHT, and the asset is not a business asset, holdover relief is not available. Holdover relief would have negated any CGT on the trust, and would have meant that Shaun would receive the asset with a base cost equal to the trustees base cost (so increased CGT on his disposal in the future).

CGT would need to be paid by 31 January following the end of the tax year and a self assessment trust return would need to be filed in the same time frame.

A major issue with this is that currently the trust does not have sufficient cash reserves to pay this liability, and hence further sales would be needed to enable the distribution of Fairview to Shaun.

This was mentioned by Paul and Claire previously as not being advisable.

(B2) Distribution of Beach Farm

Similar to the distribution of Fairview, the distribution of Beach Farm would result in

associated IHT and CGT implications.

IHT

Similar to above, the distribution of Beach Farm will be a PET from Paul to Shaun. The same principles apply regarding taper relief, however, some of the assets of Beach Farm qualify for Agricultural Property Relief (APR), which impacts the potential IHT liability.

APR can reduce the value of distributions of assets used for agricultural purposes. This includes farm land, as well as farm buildings.

APR is available at 100% IHT relief if a qualifying asset is held for 2 years (if trust farms) or held for 7 years if leased to a farmer.

However, it should be noted that APR is only available on the agricultural value of the land, and not market value.

In the case of Beach Farm, we will asset each of the individuak assets within Beach Farm in turn.

For Long Field, APR is available as it is arable land let to a local farmer for over 7 years. The agricultural value of the land (£2.45m) qualifies for 100% APR.

For the three dilapidated barns, APR is not available.

For Beach cottage, the agricultural value should also qualify for APR as farm buildings qualify if it represents character appropriate and has been occupied by a farm worker.

For Bulls Paddock, again as the land has been let for over 7 years, the agricultural value of the land should qualify for 100% APR.

For Red Cottage, although this will not qualify for APR, we can asset whether it qualifies for Business Property Relief (BPR).

BPR is available to reduce IHT liability on transfers of business property. There has been a lot of case law regarding furnished holiday lets, whereby it is almost impossible for it to qualify as a BPR, as non-land related services will have to be greater than the land related services.

It is safe to assume that Red Cottage does not qualify for BPR.

Hence, as per Appendix 2, the PET is expected to be £805,000, which only be chargeable to IHT if Paul dies within 7 years.

Another point to note is that, assuming the relevant Beach Farm assets continue to farm, if Shaun sells Beach Farm and Paul dies within 7 years, then the APR would be withdrawn. So, it is advisable for Shaun to retain Beach Farm for at least 7 years from gift to him.

CGT

From a CGT perspective, this will also be a market value distribution. So, CGT would be liable on gains (market value less probate value for each asset within Beach Farm.

This should result in a CGT liability of £324,400 as per Appendix 3 for the trustees.

However, it should be noted that there is potentially holdover available to negate the CGT liabilies of the trustees.

Holdover relief is available on business property, which agreicultural land, would be considered, as it would be used for trading purposes.

Holdover relief will need the consent of both the trustees and Shaun. The latter is particularly relevant as his base cost for CGT would lower, and he would take on the probate values, so any future disposals would result in a larger CGT liability.

If holdover relied is claimed, the deadline is 4 years from end of the tax year of transfer, so in this case 5 April 2029 for a transfer in February 2025. However, the claim is usually made with the respective self assessment returns.

Recommendations

It is recommended to distribute Beach Farm rather than Fair View, as the trustees and Shaun can claim holdover relief to negate any CGT liability.

But assets would result in a PET for IHT purposes, but it is also recommended that the farmer activities continue and Shaun retains the assets for at least 7 years to ensure that APR is not withdrawn in case Paul dies within 7 years of gift.

Section C: Leave Sunnyside and remainder of trust to Poppy or Pass Sunnyside outright to Paul now

A general background of Paul's IHT position is that he has a IPDI in the QIIP, the free estate and trust estate falls part of his death estate.

As Paul's first wife, Anna, died and left all her assets to him (total assets below £2.2m estate) and made no lifetime gifts, Paul will be able to claim transferable nil rate band and transferable residence nil rate band (RNRB) on his death at 100%.

As Anna's estate was entirely exempt from IHT, Paul can claim a further 100% of NRB, so an extra £325,000. This means that he has a total of £650,000 of NRB available to reduce any future IHT liability on his death.

RNRB allows individuals to reduce their IHT liability on death for main residential property when left to lineal descendents. Each individual has an RNRB of £175,000.

Additionally, as the RNRB was not relevant at the time of Anna's death, Paul will be to transfer Anna's RNRB at 100%, giving him an extra £175,000 RNRB and a total of £350,000 of RNRB.

(C1): Leave Sunnyside and remainder of trust to Poppy

<u>IHT</u>

If the assets are left in Paul's death estate, Sunnyside would be chargeable to IHT. The trustees would ultimately pay the IHT liability arising on this asset and others that remain on trust following's Paul's death.

The value of the house at the date of Paul's death would remain chargerable to IHT at a rate (up to) of 40%.

We would need a more up to date valuation of the house at the date of Paul's death to provide exact IHT liabilities due. But assuming the value of the house remains the same as it is now (£850,000), then this will lead to an IHT liability at 40% of £340,000.

A key point to note is that, if Sunnyside remains on trust on Paul's death, the estate will not be eligible to claim the total RNRB of £350k (mentioned above), as residential property will pass to the discretionary trust, rather than directly to a lineal descendent.

This will lead to a loss of £140,000 of extra IHT to be paid (£350,000 @ 40%).

<u>CGT</u>

There will be no CGT liability on Paul's death if the estate remains settled, as the beneficiaries remain the same.

Additionally, an advantage of retaining assets within the trust on Paul's death is that the assets will get a CGT free market value uplift to Paul's probate value.

This is particularly useful as the beneficiary will be to distribute the house (and other assets) CGT free if sold shortly after Paul's death and on distibution to them from the discretionary trust.

(C2) Distribute Sunnyside outright now to Paul

IHT

This would be deemed to be IHT neutral as the house is already in Paul's estate for IHT, as he has a QIIP.

Therefore, there would be no additional IHT liability if the trust were to distribute Sunnyside to Paul during his lifetime.

A big advantage of distributing Sunnyside to Paul during his life is that if he were to leave the property to Poppy on his will, he would be able to claim the £350k of RNRB available to him. Hence, this would reduce IHT liability by £140,000.

CGT

Similar to the distribtions mentioned above, the distribution of Sunnyside from the trust to Paul would be deemed a market value gift.

Assuming Sunnyside is distributed with a market value of £850,000, this would result in a CGT liaibility of £83,160 as per Appendix 4.

However, it should be noted that as Sunnyside is the beneficiary (Paul's) main residence, private residence relief (PRR) should be available.

PRR reduces any CGT on sale or gift of the beneficiaries main residence depending on the proportion of the beneficiary occupied and is deemed to occupy the property.

In this case, as Paul has lived in Sunnyside throughout the period since Susan's death, PRR should reduce the CGT liability to £0.

The trustees will need to claim PRR within the trst self assessment return by the 31 January following the tax year of gift. So, assuming Sunnyside is distributed before 5 April 2025, this will need to be reported in the 31 January 2026 trust self assessment return.

(C3) Other ways to reduce Paul's IHT liability on death

As Paul mentioned in his prior meeting, we will also include advice to Paul within this report.

Assuming the trust distributes Sunnyside to Paul within his lifetime, and that the remaining values of his existing estates remain the same, his estate would increase to

£400k plus value of Sunnyside.

For simplicity, assuming Sunnyside value remains the same value, that is a minimum of £1.25m.

Paul can now use his full £650,000 NRB (as mentioned above), which he would not have been had his estate remained below £650,000.

Additionally, Paul can now use his full £350,000 RNRB. This means that at least £250,000 will remain chargeable to IHT on his death.

To reduce this, Paul can ensure that he utilises his £3,000 annual exemption every year (IHT free annual allowance). He can do this by transferring, e.g. £3,000 to Poppy every 6 April.

It was also mentioned that Paul no longer needs any of the trust income to sustain his living. This means that there is opportunity to utilise the normal expenditure out of income (NEOI) IHT exmeptions on the trust income.

NEOI allows an IHT free gifts by Paul on his income that is regular, habitual and made in excess of his income, such that it does not affect his standard of living.

In this case, if Paul distributes his excess trust income to Poppy, this can be deemed IHT free (with no liability if Paul dies within 7 years). Paul would also be able to reduce his death estate laible to IHT.

Additional ways for Paul to reduce his IHT liability would be distributions up to the small gifts exemption of £250 per year per person. This will allow Paul to gift whoever

he wishes £250 per year IHT free.

Further, if any child will get married during Paul's lifetime, Paul can gift £5,000 IHT free to them.

Recommendation

It is recommended that the trust distributes Sunnyside to Paul outright now. This is because from an IHT perspective, this is IHT neutral, so there is no further IHT liability. Additionally, Paul will be to reduce his IHT liability by £140k by utilising his RNRB and TRNRB.

Paul will also be able to maximise the additional NRB available on his death.

As PRR can be claimed by the trustees, the distribution on Sunnyside will also be CGT exempt.

It is also recommended that Paul considers reducing his IHT liability further, such that it reduces his IHT liability on his death estate. This can involve making £3,000 IHT free gifts every year to utilise his IHT annual exemptions, making income distributions from excess trust income, making small gifts of up to £250 per person per tax year, or gifts of any potential marriages.

Tax Adviser LLP

14 November 2024

Appendices

Appendix 1

		£	
Proceeds		4,300,000	
Less (cost)		(2,750,000)	
Gain		1,550,000	
AEA		(3,000)	
Taxable Gain		1,547,000	
CGT @ 20%		309,400	

Appendix 2

		£	**£**

Long Field		2,700,000	
Less APR		(2,450,000)	
			250,000
Barns			220,000
Beach Cottage		300,000	
		(300,000)	
			0
Bulls Paddock		740,000	
		(620,000)	
			120,000
Red Cottage			215,000
PET			805,000

Appendix 3

		£	**£**
Long Field Market Value (MV)		2,700,000	
Long Field Probate Value (PV)		(1,700,000)	
Gain			1,000,000
Barns MV		220,000	
Barn PV		(100,000)	
Gain			120,000
Beach Cottage MV		300,000	
Beach Cottage MV		(200,000)	
Gain			100,000
Bulls Paddock MV		740,000	
Bulls Paddock PV		(400,000)	
Gain			340,000
Red Cottage MV		215,000	
Red Cottage PV		(150,000)	

Gain			65,000
Total Gain			1,625,000
Less AEA		(3,000)	
			1,622,000
CGT @20%			324,400

Appendix 4

		£	**£**
Proceeds (Current Value)		850,000	
Less Cost (Probate Value)		(550,000)	
Chargeable Gain			300,000
Less AEA			297,000
CGT @ 28%			83,160