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	**4420**	**20587**	**24780**
Total	**4420**	**20587**	**24780**

Answer-to-Question-_1_

REPORT

To: The Trustees of the Susan Wood Will Trust

From: Tax Advisers LLP

Date: 14 November 2024

Subject: Restructing of and distributions from the Susan Wood Will Trust

INTRODUCTION

This Report has been prepared following a telephone call with and email from the Trustees of the Susan Wood Will Trust (the "Trust").

This Report is based on law at 14 November 2024 and is intended for the use of the Trustees and beneficiaries of the Trust only. Tax Advisers LLP shall not accept any liability for reliance on this Report by any other party.

This Report will advise on the tax implications and provide recommendations in relation to the Trustees' proposed distributions and restructuring of the Trust.

EXECUTIVE SUMMARY

• If Beach Farm is distributed to Shaun and Fairview passes to the discretionary trust, the total tax liability for the Trustees will be £815,000.

• If Fairview is distributed to Shaun and Beach Farm passes to the discretionary trust in February 2025, the total tax liability for the Trustees will be £404,200. If the Trustees wait until Septebmer 2026 to transfer Beach Farm, they can reduce their tax liability to £306,200.

• From a tax perspective, the Trustees should choose the second option and distribute Fairview to Shaun and Beach Farm should pass to the discretionary trust.

• If Sunnyside is retained on a life interest for Paul, the property will form part of his death estate and the inheritance tax (IHT) liability on his death will be £240,000. £163,200 of this will be borne by the Trustees and £76,800 of this will be borne by the executors of Paul's estate.

• If Sunnyside is transferred to Paul's free estate, the residential nil rate band (RNRB) will become available and the IHT liability on his death will be reduced to £100,000.

• Paul could also consider selling Sunnyside and entering into a pre-owned asset tax arrangement with Poppy. This would remove Sunnyside from his death estate and he would completely eliminate his IHT liability on death.

• If Paul wishes to keep Sunnyside, he should transfer the property to his free estate. If he is willing to move into a new property, he should consider the pre-owned asset tax arrangement option.

SECTION A: Current structure of the Trust

The Trust is currently an interest in possession (IIP) settlement. Paul is entited to the income of the Trust as it arises.

Paul has a qualifying interest in possession (QIIP) in the Trust as his life interest began on the death of Susan via her Will. The assets of the Trust therefore currently form part of his death estate.

When Paul's IIP ceases in the assets, whether this is on his death or during his lifetime, the property will convert to being held on a relevant property trust (RPT).

These assets will enter the RPT regime, meaning periodic IHT charges will arise for the Trust on each ten-year anniversary of its original creation in June 2012. IHT exit charges will arise on the distribution of capital assets.

Paul will be treated as the settlor of this trust for IHT purposes because he is the final individual out of him and his spouse to have a QIIP in a trust created by his spouse.

The rate of IHT applied on these charges will therefore be based on the seven-year gifting history of Paul before the cessation of his life interest.

SECTION B: Option 1: Appointment of Beach Farm to Shaun and Fairview passing to discretionary trust

(B1) Appointment of Beach Farm to Shaun

Capital gains tax (CGT)

The appointment of Beach Farm to Shaun from the Trust as it currently stands will result in a disposal by the Trustees with the deemed proceeds being the market value of the assets within the Trust.

A capital gain will arise on the difference between the market value of the assets and their probate values. The Trustees also benefit from a £3,000 CGT annual exempt amount. The remainder is taxed at 20%, being the CGT rate for Trustees on disposals of non-residential property.

A CGT liability of £317,900 will occur on the appointment of Beach Farm to Shaun (Appendix 1).

Business asset disposal relief (BADR) is available on the disposal of Red Cottage as this has been a qualifying furnished holiday let since April 2009. The capital gain made on Red Cottage will be taxable at 10% assuming Paul's £1,000,000 lifetime allowance has not been depleted.

A joint claim will need to be made between the Trustees and Paul on disposal as the gains claimed will reduce Paul's £1,000,000 lifetime allowance. This claim will need to be made within one year of the filing date of the Trust's self-assessment tax return. This will be 31 January 2027.

A holdover relief claim can be made on the distribution of the agricultural land and property, being Long Field, the barns, Beach Cottage and Bulls Paddock. This will defer the capital gain realised on these assets when distributed to Shaun. Shaun's base cost of the assets will reduce by the amount of the gain deferred.

A holdover relief claim here would require the consent of both the Trustees and Shaun as beneficiary.

As Shaun would like to dispose of the assets relatively shortly after receiving them, Shaun should consider whether he would like to consent to the holdover relief claim as he will face a large capital gain on these assets and therefore the amount of CGT due on these assets personally in a few years' time.

However, this would reduce the CGT liability of the Trustees to simply the gain made on Red Cottage of £21,200.

The CGT due on this appointment would be due by 31 January 2026 and reportable on the Trustees' self-assessment tax return.

IHT

The appointment of Beach Farm to Shaun whilst Paul has a QIIP in the Trust will result in a PET being made by Paul. This is because the assets will be leaving his estate and passing to another individual's.

This PET will be fully exempt from IHT should Paul survive seven years from the date of gift. Taper relief will reduce the amount of IHT due should Paul survive at least three years.

The value of the PET can be reduced by agricultural propery relief (APR) on some assets. APR is available to reduce the transfer of value of assets that are used for the purposes of agriculture. APR is available on the agricultural value (AV) of assets if certain conditions are met.

APR is available at 100% of the AV of assets that have been owned by the Trustees and let to a tenant who is using them for the purposes of agriculture and this has been the case for at least seven years.

Taking each asset in turn:

APR is available on 100% of the AV of Long Field as John Croft has been the tentant of the land since May 2017.

The dilapidated barns have not been let to John for seven years so APR will not be available.

Beach Cottage is occupied by a farm employee since May 2017 so will therefore qualify for APR at 100% of the AV.

Bulls Paddock has been let to a local farmer since February 2016 so will qualify. Cattle farming is an agricultural activity.

Red Cottage will not qualify for APR as it is not used for the purposes of agriculture. It is also highly unlikely Red Cottage will qualify for business property relief (BPR), as case law has historically shown for furnished holiday lets.

Paul will make a PET of £805,000 (Appendix 1), before Paul's nil rate band has been applied, on the distribution of Beach Farm to Shaun. However, this is unlikely to result in a tax liability for Shaun given Paul's current health as he is expected to live at least seven years.

It should be noted, however, that if Shaun proceeds to sell Beach Farm within seven years of receiving it, APR will be clawed back if he no longer owns the property if Paul were to die within seven years. This is unless Shaun invests the net proceeds he receives on the sale in replacement APR-qualifying assets.

Given Paul's current health, the cost of a life assurance policy to cover against this IHT liability should Paul die within seven years should not be too prohibitive. Shaun may want to look into this option if he is particularly risk-averse.

For APR purposes, the ownership period will reset when Beach Farm is distributed to Shaun. If Shaun were to give Beach Farm away or die within seven years, APR will not be available on the AV of the assets and the transfer of value will be significantly higher.

(B2) Fairview passing to discretionary trust

<u>CGT</u>

If Fairview were to pass to the discretionary trust, this will not be a disposal for CGT purposes as the asset is not leaving the Trust.

The base cost of the property will remain at its current probate value of £2,750,000.

<u>IHT</u>

When Fairview passes to the discretionary trust, this property will leave the estate of Paul and enter the RPT regime. Therefore, a chargeable lifetime transfer (CLT) will be made by Paul.

The value of the CLT will be the current value of the property, less Paul's IHT annual exemptions (AE) for this tax year and 2023/24.

Paul's nil rate band of £325,000 is available in full as he has not made any chargeable gifts in the last seven years.

The CLT will therefore be £3,969,000, with IHT due at 20% resulting in an IHT liability of £793,800.

Importantly, Fairview should pass to the discretionary trust before the distribution of Beach Farm is made to Shaun in this option as the AEs will then be allocated to the CLT to reduce the amount of IHT due.

The IHT on the CLT is due for payment by the Trustees by 31 August 2025, if made in February 2025. This is six months from the end of the month of transfer.

A form IHT100 will also need to be filed with HMRC by this date. We can assist with this.

This CLT will be subject to further IHT should Paul die within seven years of the transfer.

Income tax

The property will be held on a discretionary trust. Income arising to discretionary trusts is taxed at the Rates Applicable to Trusts (RAT).

Non-savings income such as rental income arising from this property will be taxed at 45% in the hands of the Trustees.

It should be noted that a tax pool should also be kept by the Trustees. This pool will be increased by the tax paid by the Trustees on sources of income such as rental profits. It will be decreased by any tax credits accompanying income distributions to beneficiaries.

We can assist with keeping the Trust's tax pool up-to-date.

Stamp duty land tax (SDLT)

There are no SDLT problems to consider here as no consideration is being paid by the Trust for the property.

(B3) Summary

Under this option, on the distribution of Beach Farm there will be a CGT liability due for the Trustees of £21,200 if holdover relief is claimed, with no immediate IHT liability and no IHT liability should Paul survive seven years.

There will be an IHT liability of £793,800 on the transfer of Fairview to the discretionary trust.

This total tax liability under this option is £815,000.

The Trust currently does not hold sufficent funds for this option to be claimed, so this option is not recommended.

SECTION C: Option 2: Appointment of Fairview to Shaun and Beach Farm passing to discretionary trust

(C1) Appointment of Fairview to Shaun

CGT

The appointment of Fairview to Shaun will be a disposal by the Trustees as the asset is leaving the Trust. The proceeds of the disposal will be the market value of the property.

A capital gain will arise on the difference between the market value of the property and its probate value.

The Trustees are able to benefit from a £3,000 CGT annual exempt amount. The remainder is taxed at 20%, being the CGT rate for Trustees on disposals of non-residential property.

A CGT liability will arise on the appointment of Fairview to Shaun of £309,400 (Appendix 2).

No holdover relief is available on the appointment of Fairview as the transfer is not immediately chargeable to IHT (see below) and is not considered a business asset.

Shaun's base cost of the property will therefore be its current market value of £4,300,000, meaning his capital gain on the disposal of the property in a few years' time should be relatively low. Shaun is also able to benefit from a larger annual exempt amount of £6,000.

This disposal will be reported on the Trustees' self-assessment tax return, due 31 January 2026. The tax will be due for payment on the same date.

IHT

The appointment of Fairview whilst Paul has a QIIP in the Trust will result in a PET being made by Paul. This is because the assets will be leaving his estate and passing to another individual's.

This PET will be fully exempt from IHT should Paul survive seven years from the date of gift. Taper relief will reduce the amount of IHT due should Paul survive at least three years.

The value of the PET, before Paul's nil rate band is applied, will be the current market value of the property, being £4,300,000.

Under this option, the distribution of Beach Farm should be made before the appointment of Fairview in order for Paul's AEs to be applied against the value Beach Farm instead of Fairview.

Given Paul's current health, this PET is unlikely to become chargeable as he is expected to live more than seven years.

It should be noted, however, that if Shaun proceeds to sell the property, the IHT due on this PET if Paul were to die within seven years will still be chargeable on Shaun.

Similar to with option 1, given Paul's current health, the cost of a life assurance policy to cover against this IHT liability should Paul die within seven years should not be too prohibitive. Shaun may want to look into this option if he is particularly risk-averse.

(C2) Beach Farm passing to discretionary trust

<u>CGT</u>

If Beach Farm were to pass to the discretionary trust, this will not be a disposal for CGT purposes as the assets within the farm are not leaving the Trust.

The base costs of the assets will remain at their current probate values.

<u>IHT</u>

When Beach Farm passes to the discretionary trust, this property will leave the estate of Paul and enter the RPT regime. Therefore, a chargeable lifetime transfer (CLT) will be made by Paul.

The value of the CLT will be the market value of the assets, reduced by APR where available, less Paul's IHT annual exemptions (AE) for this tax year and 2023/24.

Paul's nil rate band of £325,000 is available in full as he has not made any chargeable gifts in the last seven years.

APR will be available in line with the explanations provided in Section B1 of this Report.

The CLT will therefore be £474,000, with IHT due at 20% resulting in an IHT liability of £94,800 (Appendix 2).

It should be highlighted that if the Trustees wait until after August 2026 to make this transfer, APR will be available on the AV of the three dilapidated barns as they will have then been let for at least seven years. This will save further IHT of £220,000 at 20% = £44,000.

The IHT due on this CLT will be due for payment by the Trustees six months after the end of the month of transfer.

If the CLT is made in February 2025, the IHT will be due on 31 August 2025.

If the CLT is made in September 2026, the IHT will be due by 31 March 2027.

A form IHT100 will need to be filed with HMRC by the same date and we can assist with this.

(C3) Summary and recommendation

Under this option, on the distribution of Fairview there will be a CGT liability due for the Trustees of £309,400, with no immediate IHT liability and no IHT liability should Paul survive seven years.

There will be an IHT liability of £94,800 on the transfer of Fairview to the discretionary trust. This can be reduced by £44,000 to £50,800 if the Trustees wait until after August 2026.

This total tax liability under this option is £404,200 if the transfer is made in February 2025.

This is a lower tax liability than under option 1 and can be further reduced to £360,200 if the Trustees wait until September 2026.

From a tax perspective, option 2 is recommended.

SECTION D: Sunnyside

(D1) Current position - Sunnyside retained on life interest

As discussed, the assets in the Trust on which Paul holds a QIIP will form part of his death estate.

On the assumption that option 2 above is taken, neither Fairview nor Beach Farm will remain in Paul's estate if he were to die.

The Trustees have also told us that any remaining cash in the Trust, after payment of the above-mentioned tax liabilities, will be likely used up in the next couple of years.

It will therefore only be Sunnyside from the Trust that will remain in Paul's death estate.

Paul has told us that his workplace pension lump sum death benefit is written in trust for Poppy. This lump sum will therefore not make up part of Paul's death estate.

Using current values, Paul's death estate totals £1,250,000 (Appendix 3).

Paul's nil rate band (NRB) can be uplifted by 100% because his first wife did not use any of her NRB on death. Her entire estate will have been exempt under the spouse exemption.

Under how Paul's Will is currently drafted, he will not be able to access the RNRB. This is up to £175,000.

The RNRB is available on estates where a property which has at some point been the deceased's main residence passed to a lineal descendant though the Will of the deceased.

Currently, when Paul dies, Sunnyside will transfer to the discretionary trust. This blocks the availability of the RNRB as, even if Paul's lineal descendants are beneficiaries of the Trust, the RNRB is not available where it passes on death to a discretionary trust.

The IHT exposure on Paul's death is currently £240,000. £163,200 of this will be borne by the Trustees and £76,800 of this will be borne by the executors of Paul's estate (Appendix 3).

This tax position can be improved.

(D2) Sunnyside passes to Paul outright now

<u>CGT</u>

If Sunnyside were to pass to Paul during his lifetime, the Trustees will make a disposal for CGT purposes.

The property has increased in value since it was left on trust at Susan's death by £300,000. However, this capital gain on Sunnyside can be fully extinguished through private residence relief (PRR).

PRR is available when a property has been occupied by an individual as their main residence. This relief is expanded to include occupation by beneficiaries of trusts where they have a life interest.

Paul's has occupied the property as his main residence through the entire time the Trust has owned the property. PRR is therefore available in full. The Trustees need to claim this relief on their self-assessment tax return.

No CGT liability will arise as a result of the property passing to Paul outright.

Paul will obtain Sunnyside with the base cost equalling the current value of the asset of £850,000.

As Paul will continue occupying Sunnyside, he should be able to claim PRR to exempt the whole gain if he does dispose of this property in the future.

<u>IHT</u>

There will be no immediate IHT implications as a result of Sunnyside passing from the Trust to Paul personally because the asset is not leaving his estate for IHT purposes. There is not transfer of value.

As a result of the transfer of Sunnyside from the Trust to Paul's free estate, the RNRB will be available. This is because his last Will leaves everything to Poppy.

The Will could also leave this property to Emily directly as Emily is also considered a lineal descendant of Paul.

Similar to Paul's NRB, his RNRB can be uplifted by 100% because his first wife, Anna, did not use any of her RNRB on her death.

The relief did not existing at the time, however, Anna is still treated as having used 0% of her RNRB.

Paul's nil rate bands now total £1,000,000.

With the availability of both 200% of the usual NRB and 200% of the RNRB, Paul's IHT liability on his death will be reduced to £100,000 if Sunnyside forms part of his free estate (Appendix 3). This is on the assumption that Paul dies more than seven years from Beach Farm passing to the discretionary trust.

None of this IHT will be borne by the Trustees.

Out of the two options originally suggested by the Trustees, the option where Sunnyside is passed to Paul right now is favourable as this unlocks the RNRB and significantly redudes the IHT liability on his death.

(D3) Further considerations

A further way of reducing the value of Paul's chargeable estate on death and, as a result, his IHT liabilty, is for Paul to sell Sunnyside and then gift the proceeds to Poppy.

Poppy could then purchase a house with the gift from Paul and allow him to move in.

This option will result in Paul having to move out of Sunnyside and into an alternative property, so it may not be appropriate if Paul has personal connections to Sunnyside.

CGT

The sale of Sunnyside would result in a disposal for CGT purposes.

As outlined in Section D2, this disposal can be completely exempted from CGT due to the availability of PRR.

Paul will need to claim for PRR on his self-assessment tax return.

IHT

The gift of cash proceeds to Poppy will be a PET by Paul. Ignoring AEs, the value of the PET in excess of Paul's NRB will be chargeable to IHT if Paul dies within seven years, being £525,000. Poppy will bear the IHT due of £210,000.

Taper relief will reduce the IHT due should Paul survive three years.

Poppy could take out a life assurance policy on Paul's life to cover against the IHT liability arising if Paul were to die within seven years and Poppy is particularly risk averse.

The property will no longer be in Paul's estate. After seven years, the PET will be exempt and Paul's NRB will be available in full to offset against his cash and quoted investments.

Under this arrangement, Paul's IHT liability on death will be reduced to nil (Appendix 3).

Income tax

This arrangement will result in Paul being faced with a pre-owned asset tax charge. This arises where an individual can benefit from the use of an asset purchased with cash he has previously gifted.

The pre-owned asset tax charge will create notional income for Paul equal to the annual rental value of the house he has moved in to. This will be taxed as his top slice of income at non-savings tax rates (40% for higher rate taxpayers).

This tax charge can be reduced by payments made to Poppy for Paul's use of the property. One should be mindful of doing this, however, as this can create a tax charge for Poppy if she makes a rental profit as a result of the payments.

The optimal solution here is for Paul to pay Poppy for the expenses of running the property, for example the council tax, electricity, water and gas bills. Poppy will then not make a profit and Paul will reduce his tax charge.

Paul's estate will also reduce slowly over time as a result of payment of the expenses to Poppy.

Both Paul and Poppy will need to report this income on their self-assessment tax returns. We can assist with this if required.

Before we can act for Poppy, we will need to complete all the usual client onboarding and acceptance procedures, including anti-money laundering (AML) checks.

SDLT

If Poppy already owns property and purchases another, she will be liable to pay SDLT on the value of the new property at the higher rates which are 3% higher.

Tax Advisers LLP
14 November 2024

Appendix 1

CGT liability for the Trustees on the appointment of Beach Farm from the Trust to Shaun

	Total	Long Field	Barns	Beach Cottage	Bulls Paddock	Red Cottage
	£	£	£	£	£	£
Proceeds		2,700,000	220,000	300,000	740,000	215,000
Less: probate value		(1,700,000)	(100,000)	(200,000)	(400,000)	(150,000)
Gain		1,000,000	120,000	100,000	340,000	65,000
Less: AEA				(3,000)		
Taxable gain		1,000,000	120,000	97,000	340,000	65,000
CGT @ 10%						6,500

CGT @ 20%		200,000	24,000	19,400	68,000	
Total CGT liability	317,900					

Value of PET on appointment of Beach Farm to Shaun

	£	£	£	
Long field	MV	2,700,000		
	Less: 100% AV	(2,450,000)		
			250,000	
Barns	MV	220,000		
	Less: 0% AV	(nil)		
			220,000	
Beach Cottage	MV	300,000		
	Less: 100% AV	(300,000)		
			Nil	
Bulls Paddock	MV	740,000		
	Less: 100% AV	(620,000)		
			120,000	
Red Cottage	MV		215,000	
PET			805,000	

Appendix 2

CGT liability for the Trustees on the appointment of Fairview from the Trust to Shaun

		£		

Proceeds (MV)		4,300,000		
Less: probate value		(2,750,000)		
Gain		1,550,000		
Less: AEA		(3,000)		
Taxable gain		1,547,000		
CGT @ 20%		309,400		

IHT liability for the Trustees on Beach Farm becoming a part of the RPT regime

	£	£	£	
Long field	MV	2,700,000		
	Less: 100% AV	(2,450,000)		
			250,000	
Barns	MV	220,000		
	Less: 0% AV	(nil)		
			220,000	
Beach Cottage	MV	300,000		
	Less: 100% AV	(300,000)		
			Nil	
Bulls Paddock	MV	740,000		
	Less: 100% AV	(620,000)		
			120,000	
Red Cottage	MV		215,000	
			805,000	
Less: AEs x2			(6,000)	
Less: NRB			(325,000)	
CLT			474,000	
IHT @ 20%			94,800	

Appendix 3

Paul's current IHT exposure on his death

			£	
Cash and quoted investments			400,000	
Sunnyside			850,000	
			1,250,000	
Less: NRB			(650,000)	
Less: RNRB			(nil)	
Chargeable estate			600,000	
IHT @ 40%			240,000	

Borne by Trustees: (850,000/1,250,000) * 240,000 = £163,200.

Borne by Paul's executors: (400,000/1,250,000) * 240,000 = £76,800.

Paul's IHT exposure if Sunnyside forms part of his free estate

			£	
Cash and quoted investments			400,000	
Sunnyside			850,000	
			1,250,000	
Less: NRB			(650,000)	
Less: RNRB			(350,000)	
Chargeable estate			250,000	
IHT @ 40%			100,000	

Paul's IHT exposure if he enteres into a pre-owned asset arrangement

			£	
cash and quoted investments			400,000	
Less: NRB			(400,000)	
Chargeable estate			Nil	
IHT @ 40%			Nil	