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

Event **NA**

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Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**3227**	**15193**	**19936**
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Answer-to-Question-_1_

To: Trustees of the Cresswell Family Settlement
From: Alison Clarke
Date: 05/05/2021
Subject: Tax issues in relation to the Cresswell Family Settlement.

This report has been prepared by ABC Tax and considers the issues raised in your email dated 01 May 2021.

This report has been prepared for the Trustees of the Cresswell Family Settlement and is intended for use by them only. No responsibility is accepted for any reliance placed on the contents of this report by third parties. It is based on tax legislation as it applies at the time of writing and any changes to the legislation may affect the conclusions of this report.

Contents:

Abbreviations:

The Trust - Cresswell Family Settlement
CGC - Cresswell Garden Centres Ltd.

CGT - Capital Gains Tax
IHT - Inheritance Tax
NRB - Nil Rate Band
BPR - Business Property Relief
APR - Agricultural Property Relief
BADR - Business Asset Disposal Relief.
PPR - Principal Private Residence

Executive Summary:

The Trustees required additional funds to settle the outstanding Inheritance Tax (IHT) charge on the trust following the death of the settlor, Lilly, in 2019. Two options we proposed to sell the Bramble Cottage, or the Paddock.

It was concluded that Capital Gains tax (CGT) charges were very similar, and both options provided enough net 'cash' to covert the liability. Recommendations were subsequently made to sell the Cottage in priority primarily due to the Agricultural Property Relief (APR) advantages that the paddock offers by retaining the asset in the Trust.

On the 30th birthday of the eldest beneficiary, Amanda, she will be entitled to her share of the trust capital. This would be an IHT and CGT event. £31,500 would be due on the IHT appointment and in the absence of any relief claimed for CGT 37,485 would be due.

A recommendation was made to the trustees to make a joint election, with the beneficiaries, to holdover the gains on the appointment. This was there would be no CGT charge, and no requirement for the trustees to sell further assets to raise cash to meet the liability.

It was concluded that the Cresswell Garden Centres Ltd Shares are mainly trading (over 50%) and would be eligible for Business Property Relief (BPR). The excepted assets held include the floor space let to the retail stores, will be excluded and the percentage chargeable in full.

In conclusion, recommendations were made to appoint Darcy's share now to secure BPR on the appointment, incase the activities change voiding the shares from any relief in 2023, and also avoiding a CGT charge in 2023, for Amanda's 50% charge in the land.

Section 1: Funding of the Inheritance tax liability following Lily's death.

You have asked us to compare and recommend the best option to raise cash to meet the IHT liability by either

- Selling Bramble Cottage, or
- The Paddock.

Trustees are chargeable to CGT, and pay CGT in the same way as an individual.

The proceeds will be the sale price.

When a trust acquires assets from settlor, the base cost of the asset is equal to the market value, which is reduced if a Gift

Relief claim is made.

The base cost is further increased by the IHT paid on the creation of the trust, apportioned to each chargeable asset. So this excluded the cash, and the CGC shares which qualified for BPR.

Please see Appendix 1 where i have calculated the base cost for each asset in the Trust.

1A Sell Bramble Cottage,

The estimated proceeds is £99,000 based on the estimated value.

As the gain was heldover on the transfer to the trust, the base cost for the Cottage is £85,912. After deducting the auction and legal fees of £1,485, the net gain is £13,088.

After the Trust's annual exemption of £6,150, the tax due (which is on the higher rate of 28% as residential property) is £1,943.

See Appendix 2.

This is due within 30 days of completion, so circa 30 June 2021, or when the property completes.

There are no Stamp Duty considerations for the seller of a property.

The Net 'cash position for the Trust is

Proceeds	99,000
Less: Cost of sale	(1,485)

Less: CGT	(1,943)
	95,572

Which covers the outstanding IHT of £70,500, with £25,000 surplus, for potential charge to wind up the Trust.

1A Sell The Paddock

See Appendix 2.

The calculation follows the same template as the sale of the Cottage.

The main difference being that the gain will be subject to the lower CGT rate of 20%, as it is not the disposal of a residential property.

The CGT due would be £1,295

The net 'cash' position for the Trust is

Proceeds	94,000
Less: Cost of sale	(500)
Less: CGT	(1,295)
	92,205

1C IHT considerations:

It is possible for the Trustees to claim an APR on The Paddock.

APR reduces the value of an asset for IHT purposes if it is qualifying agricultural property.

Agricultural property can be defined as growing crops.

As the land is let to an in dependant farmer for them to do this there are certain ownership conditions which need to be met.

such as the land must be owned by the Trust for 7 years, and used for agricultural purposes during this whole time.

The trust will therefore qualify for this relief on the 7th year of ownership, on 12 August 2021.

The impact on the relief will be on any appointments of assets to the grandchildren, there will be no charge to IHT on the Agricultural value.

As the relief will be on the agricultural value only, and not any development potential, the value of the land will need to be apportioned. this can be done by an in dependant valuer.

1D Recomendations

We would recommend that the Trustees should sell the Cottage over the Paddock.

The difference is CGT between a sale of the Bramble and The paddock is not material, but the Trustees will realise more cash by selling the property and will be able to cover future liabilities (including IHT).

The Cottage is also more likely to sell more expediently, and the quicker it sells the sooner the IHT liability can be settled stopping nay additional interest and penalties.

The main advantage to holding the land is that is qualifies for APR and the value of the Agricultural value will be exempt from any appointment to the grandchildren following the seven years of ownership.

The Trustees must remember to pay the CGT within 30 days of completion of the sale as penalties and interest could be due.

Section 2: Tax issues on the beneficiaries becoming 30 (absolutely entitled).

Background:

The trust is an Interest in possession trust for the benefit of Amanda and Darcy (the 'beneficiaries')

On the 30th birthday the beneficiaries will become absolutely entitled to their share.

On this event the following taxes must be considered:

- IHT
- CGT
- Income tax (the assets will be taxable on the beneficiaries on an arising basis going forward).

2A IHT

As the Trust was created after March 2006 it falls within the 'relevant property regime' for IHT purposes.

This means that:

- IHT will be levied whenever there is a capital distribution (which includes entitlement to capital at 30) ('Exit Charge')

- IHT will be levied on each 10 year anniversary from the creation of the trust (as the first anniversary falls after the youngest, Darcy, reaches the age of 30, there will not be a 10 year charge, so we will not be considering the implications)

IHT- Exit Charge

exit charges are dependant on the 'effective rate' of the trust.

The effective rate is based on the initial values of the trust, the NRB at the event date (amount is £325,000, and on a 30th birthday) and then deducted from the settlor's chargeable transfers (i.e. gifts that become chargeable) in the seven years prior.

As the chargeable gifts made by the settlor (Lily), being Sandy Villa and Highbury House, for £205,000 and £206,000 respectively, exceed the NRB for the Trust (£325,000) the effective rate charge will apply of 20%.

The is then multiplied by 30%, and prorated for the number of complete quarters (3 month periods) which have elapsed between the date of Settlement (12 August 2014)and the date of exit. The maximum rate of tax is 6%

Assuming Amanda receives her share on her birthday 18 September 2021, the complete quarters will be 28.

The rate of tax will therefore be 28/40 * 6% = 4.2%

This charge will then be applied to the assets from the Trust.

As discussed above in section 1 the Paddock will qualify for APR (on the agricultural value).

The CGC shares qualified for BPR on the settlement into the trust, and for the purposes of this exercise in section 2 we will assume the shares still qualify, but this is discussed in more detail in section 3.

The charge on Amada's 30th birthday would be £31,500

			£
Wilton House	50% of 1,500,000		750,000
Bramble Cottage (Nil as assumed sold)			
The Paddock	50% of 94,000	47,000	
Less: APR		(47,000)	-
CGC Shares	50% of	1,312,500	
Less: BPR		(1,312,500)	-

Tax 4.2% * 750,000 = 31,500

This is on the assumption the values do not vary considerably from now until her birthday.

For Darcy, in the absence of any changes to the terms of the trust, or any losses in relief (to BPR/APR), the same event will happen on her 30th birthday.

The values must be adjusted to reflect the market values at that time, and the rate of tax will increase to 5.25% (35/40*6%) to reflect the increase in complete quarters from settlement to her birthday.

The trustees do have the power to appoint assets sooner, which could be a consideration, if they seek fit, to appoint assets to Darcy before her 30th birthday.

The tax will be slightly increased if the trustees decide to pay the IHT with the surplus from the sale of the cottage. alternativly, the beneficiary can pay the tax and the cash can be appointed (increasing the IHT by 44.2% on the cash amount).

2B CGT

An appointment of assets is a deemed disposal for CGT purposes.

The disposal will take place at market value. This mean that for calculating any gains on the disposal, the trustees are deemed to sell (and beneficiaries deemed to buy) the assets for an equal amount to the market value at the date of the appointment.

For CGT purposes the cash is exempt, so no charge.

For the remaining chargeable assets, in the absence of any relief there will be a substantial CGT charge.

see appendix 3: (37,485+ 121,951+ 1,313) 160,749 would be due on the appointment on Amanda's birthday.

Although, due to an old tax case called *Crowe and Appleby*, on the share of the residential property and, there will be no tax charge until the final beneficiary receives their share (as the assets are undividable), so the liability is reduced to £37,485.

This however does restrict Amanda's ability to claim holdover relief in the future. so on Darcy's entitlement the 50% of the gain (charge of : 121,951+ 1,313) would be payable by the trustees. This is addressed later in the report.

The option is not preferable, as the trustees would have to raise cash (by selling the assets) to pay the liability.

The alternative would be to holdover the gains via gift relief.

The beneficiaries would assume the asset at the base cost of the trustees, plus any IHT paid on the chargeable assets on the appointment.

There would be no immediate charge and the beneficiaries could sell the assets when they want making use of their own personal allowances.

The claim needs to be made jointly (signed by the beneficiary and the trustees) within 4 years from the end of the tax year. For Amanda that would be 5 April 2026.

If the beneficiary were to become non-resident within 6 years the tax would be clawed back.

We would recommend that this is made.

Section 3: Changes to Cresswell Garden Centres Ltd.

BPR exempts up to 100% of the value of a transfer attributable to relevant business property. This includes on the appointment of assets out of the trust.

Relevant Business Property includes shares in an unlisted trading company (for which CGC is).

There are two conditions which must be met.

The first is satisfied - the ownership condition, meaning the shares must be held for at least 2 years.

The second condition is the trading condition:

BPR is not available where the business carried out by the company consists wholly or mainly in dealing in investment activities.

In this context that means more than 50%.

CGC has investment activities being the letting of 40% of the shop floor to other retailers, but as long as this part of the business does not exceed 50% the shares will be eligible for BPR.

WE must examine various factors to determine whether the business is 'mainly trading'. The financial information, as provided, is sufficient.

The factors to be considered are:

- How turnover is split between the trading and investment parts:

In the two years to date the turnover was slightly higher in the trading arm.

- The profit generated by the trading and investment parts:

The profit is higher from the investment part, but due to the turnover being higher in the trading side, the lower profit is likely to do with the higher expenses incurred from the trading side.

- Capital employed by the business (the value of the assets used in the two different parts) :

The value of the trading part is more favourable in a 60/40 split, based on the allocation of the floor space.

- Expenditure and time spent by directors:

Based on the profits and the number of employees working in the trade vs the investment side, it seems clear that more time and effort is being spent on the trade side.

- Finally, the overall context of the business:

It seems clear that main aim of the business is the trade, and the letting of the properties is a side part.

considering all the factors together, on balance we would consider this business to currently be trading business and be eligible for BPR.

We must now consider if BPR would apply on the whole value of the shares:

<u>Excepted Assets:</u>

BPR is restricted where the value of the shares consist partly of assets which re neither:

- used wholly or mainly for the business throughout the last 2 years, nor
- is required for future business use.

'business' in this sense does not have to mean 'trade'. if an asset is an investment, but part of the overall business of the trade then they will not be excepted, and will qualify for BPR.

There are two parts of the investment side that must be considered.

- the floor space let to the retail shops
- the floor space let to the Cafe.

The Cafe, is much more straightforward, although this is an investment activity, as the Cafe is located in the store and is used as part of the overall business, i.e. it is part of the attraction of going to the garden centre, but also stop for lunch, etc.

Therefore we believe that the value of the shares attributable to the Cafe's will not be excluded.

The floor space let to the retail stores are not a straightforward.

As the stores are unrelated to the garden equipment and bulbs sold (clothes and shoes sold), it could be argued that the shares are not part of the overall business and will likely be excluded.

From the basis of the email, we have surmised that the floor space is no longer part of the floor space, and has not been used since the Summer of 2019, which, although unspecific, assumes the 2 year window is very soon.

Based on this evidence, we would conclude the value of the retail stores are likely not going to qualify for BPR on an future appointment.

In conclusion

As matters stand the allocation of the CGC shares on Amanda's 30th birthday (appointment to her) will qualify for BPR, but the value of floor space let retails stores must be excluded, increasing the IHT charge.

If the trustees were able to incorporate the floor space let to the retails stores into the actual business this will allow then full relief.

The trustees should be aware, that any increase in investment activities could result in the shares not being mainly trading and excluding the value as a whole from BPR.

An option would be to appoint Darcy's share in the trust fund to her when the shares are appointed to Amanda. This is on the assumption they are comfortable with her receiving her share in the assets absolutely now.

(to note: The Trustees have powers to do this, but the formalities should be drawn in a deed up by a solicitor.)

This way BPR would be protected on the shares, and the actual rate of tax on the appointment will decrease, from 5.25% to 4.2% on the chargeable value at the date of appointment.

Crowe & Apply, would also not apply and the assets can be heldover in full, so no CGT charge arising on the appointment of the land and residential property on Darcy's 30th birthday - deferring a charge of(121,951+ 1,313) = £123,264

ALISON CLARKE
ABC TAX

Appendix 1:

Capital Gains Base cost

		CGC	Wilton House	Bramble Cottage	Paddock
Acquisition Cost	N1	2,250,150	420,000	72,000	70,000
IHT on appointment in 2014		NIL	208,923	12,427	10,873
Base cost		2,250,150	628,923	84,427	80,873

for CGT
|---------|---------|---------|---------|---------|---------|

N1 - The unrealised gains were heldover on the settlement into the trust, so the Trustees assumed Lily's base cost.

Lily's base cost for CGC

	Holding	Cost
Incorporation	500	500
Percy's death	500	7,500,000
	1,000	7,500,500
Less: Appointment to Trust 2014	(300)	(2,250,150)
	700	5,250,350

N2 - Oliver's schedule collates the IHT paid on the creation in 2014, and the additional on Lilly's death in 2019.

Only the IHT on settlement £233,000 is allowable as a relief. As we do not have the exact figures to hand i have prorated by reference to the below:

233,000 (IHT 2014) /300,000 (IHT 2014 + 2019) * the figures in Oliver's schedule.

n.b. although Lily heldover gains, she would not have been able to holdover the loss into the trust. The Paddock's base cost, is the market value at acquisition.

Appendix 2

Sale of Bramble Cottage

Gross proceeds			99,000	
Less:				
Base cost (above)		(84,427)		
Cost to sell (1.5%)		(1,485)		
			(85,912)	
			13,088	
Less: Annual exemption			(6,150)	
			6,938	
CGT @ 28%		1,943		

1B - Sell the Paddock.

Paddock

Gross proceeds			94,000	
Less:				
Base cost		(80,873)		
Legal Fees		(500)		
			(81,373)	
			12,627	
Less: Annual exemption			(6,150)	
			6,477	
CGT @ 20%		1,295		

APPENDIX 3:

Deemed disposal, no claim

		CGC	Wilton	Bramble	Paddock

		House	Cottage	
Deemed disposal	2,625,000	1,500,000	-	94,000
Base cost for CGT	(2,250,150)	(628,923)	Sold	(80,873)
Net gain for CGT	374,850	871,077		13,127
CGT charge	20%	28%		20%
Tax due	74,970	243,902		2,625
50%	37,485	121,951		1,313

Ignore CGT allowance for the purpose of the estimate
