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Course **CTA APS IHT Trusts and Estates**

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Answer-to-Question-_1_

REPORT

To: Emily Taylor
From: Lucy Evans
Date: 8 November 2021
Re: Inheritance tax planning

INTRODUCTION

This Report is prepared for Emily Taylor. It is based on the information provided by you and your email correspondence of 1 November 2021, and is issued in accordance with our engagement letter dated 25 February 2020.

This Report is intended solely for you. Chartered Tax Advisers LLP accepts no responsibility for any reliance placed on this Report by other parties.

This Report will consider the following

- SECTION A: The current inheritance tax position
- SECTION B: The tax implications of your proposals
- SECTION C: Tax mitigation opportunities
- SECTION D: Power of Attorney

EXECUTIVE SUMMARY AND KEY RECOMMENDATIONS

Emily Taylor proposals

It is recommended that Beach House be retained and pass via the will in order to benefit from the CGT uplift on death.

In order to ensure equality between Charlotte and Susan, the cash gifts should be made at the same time.

In order to obtain an additional CGT benefit, the gift to the charity should be made by a lifetime gift of quoted shares standing at large capital gains.

Tax mitigation proposals

It is recommend that the premium bonds and ISA are gifted to your daughters as soon as practicable as a further means of reducing your estate.

It is recommended that the balance of the estate reduction be made by gifting shares. Depending on the level of gains, this may need to be done over 2 tax years to maximise the CGT annual exemption.

It is recommended that you seek to maximise your available exemptions and consider spending money for your own benefit on items that will not increase in value.

Due to equality being paramount, we do not recommend using a discretionary trust to pass assets to your grandchildren

Power of Attorney

In light of your failing health, you souls consider granting a power of attorney in favour of your daughters.

REPORT TO EMILY TAYLOR

SECTION A: CURRENT INHERITANCE TAX POSITION

Without advance planning the inheritance tax (IHT) payable on death will be £950,000. (Appendix 1)

This will be borne by your daughters.

As you have made no chargeable gifts in the previous 7 years, your current nil rate band (NRB) is £325,000.

The NRB is the amount of your estate taxed at 0%.

Your late husband used his NRB in gifting £255,000 to your daughters on his death. As such, none of his NRB can be transferred to you.

As you are leaving your main home (Rosewood Cottage) to lineal descendants (your daughters), Residential nil rate band (RNRB) is available to reduce your taxable estate.

The RNRB is currently £175,000. As Harry died before 2017, you can claim 100% of his RNRB, giving a total of £350,000.

Unfortunately, the RNRB is not currently available as your estate is too high. RNRB is restricted for estates over £2 million.

Full RNRB is available if the estate can be restricted to below £2 million. Doing so would reduce your IHT liability by £140,000 (£350,000 x 40%).

This can be done by making lifetime gifts to your daughters. These gifts will be Potentially Exempt Transfers (PETs) for IHT purposes. Unfortunately, their full benefit is restricted by your limited life expectancy. As such, they will remain liable to IHT at 40%

They can however achieve the aim of removing assets from your estate, thereby reducing its value.

Section B: The tax implications of your proposals

B1. Gift Beach View to your daughters

Inheritance tax

The gift of the property is a PET and will remove the property from your estate and fix its value for future IHT purposes.

However, due to your limited lifespan, on your death, your daughters will be liable to IHT at 40% on the value of the asset at the date of the gift.

Business Property Relief (BPR) is available where a trading business has been owned for more than 2 years.

If available, BPR would eliminate the value of the Beach View in your estate.

Unfortunately, recent case law has indicated that BPR will only be available where the level of non-land services (cleaning, laundry, on-site facilities) significantly exceeds the land services (lettings).

Given the limited services provided, it is unlikely that BPR will

be available.

Capital gains tax (CGT)

As you and your daughters are connected persons, for CGT purposes the asset is deemed to pass at market value even when gifted.

This means that you are deemed to have sold and immediately re-acquired the asset at its market value on the date of the gift (£600,000).

This will produce a gain of £420,000

Unlike IHT, furnished holiday letting (FHL) is deemed to be a trade for CGT purposes.

This means that it will qualify for a number of CGT reliefs.

As you will be disposing of a business that you have owned for over 2 years, Business Asset Disposal Relief (BADR) is available.

This taxes gains at 10% up to a lifetime limit of £1 million.

As such, ignoring annual exemptions, this would give rise to a CGT liability of £42,000 on the gain.

As the gain relates to residential property, you will be required to file an online CGT return within 30 days of completion. We can assist with this.

A payment on account of CGT must also be made within the same 30 day period.

The gain would also need to be reported on your self-assessment tax return.

As higher rate taxpayers, your daughters would be liable to CGT at 28% on any gain.

As your daughters plan to retain the property for a year or so, an alternative would be to let the property pass to them via your will.

They would then benefit from the free CGT uplift on death. This would give them a base cost of £600,000 for any future sale. In all probability, this would result in little or no CGT being paid

Additionally, if they themselves retained the property for 2 years, any gain made by them would qualify for BADR

Recommendation

Beach House should be retained and pass via the will.

B2. Cash gifts to daughters

Inheritance tax

The gifts will be PETs for IHT purposes. The implications are as mentioned above.

However, a further implication arises should you make the gifts in separate tranches.

The NRB is given chronologically, so assuming Beach House is retained, the cash gifts will be your first gifts.

The gift to Charlotte would be fully covered by your available NRB. This would mean that Charlotte would have no further liability to tax on your death.

As Susan is receiving the gift later, only £75,000 of your NRB remains.

On your death Susan would have only £75,000 to set against her gift, leaving £175,000 liable to IHT at 40%.

Susan would therefore have an IHT liability of £70,000 payable within 6 months of the end of the month of your death.

Making the gifts at the same time would equalise the NRB allocation.

Capital gains tax

Cash is an exempt asset for CGT purposes. Accordingly, there are no CGT issues with the gift.

Recommendation

I note that equality of gifting is paramount to you and therefore recommend that the gifts be made at the same time. Clearly this would risk delaying the gift to Charlotte

B3. Gift to charity

Gift via will

Gifts to charity are exempt for IHT.

In addition, where the value of the gift exceeds 10% of the baseline amount, essentially the net estate ignoring the charitable gift and the RNRB, IHT is payable at a reduced rate of 36%.

Given the value of your estate, the legacy would need to be

substantially higher than the proposed £50,000 in order to qualify.

The exempt gift will reduce your estate by £50,000 saving IHT of £20,000.

Lifetime cash gifts

Assuming you wish to gift £50,000, the alternative would be to make lifetime gifts to this value.

The gift is an exempt transfer for IHT and as an added incentive, income tax (IT) relief is available where the donation is made via the Gift Aid scheme.

IT relief is given by increasing your basic rate band by the gross value of the gift, thereby reducing the amount of income subject to higher rate tax.

The charity is also able to claim back the 25% tax relief. This is not available to it where the gift is made on death.

It is also possible to spread the gift over 2 tax years in order to maximise the IT relief.

There are no CGT implications for a cash gift.

Lifetime gift of quoted shares

Rather than gift cash, you could gift some of your quoted shares to the charity.

The transfer is exempt for IHT and takes place at no gain no loss for CGT purposes.

As such, it affords an opportunity to transfer some of your

quoted shares standing at large gains without incurring a CGT liability.

The value of the gift is a deductible payment for IT purposes, so relief will be given at your marginal rate.

Recommendation

It is recommended that the charity donation be made by way of lifetime gift. Gifting the quoted shares would be the preferred option as although the IT implications are the same, there is the added CGT benefit.

Section C: Tax mitigation proposals

Your proposed gifts of cash to your daughters will reduce your death estate by £500,000.

The estate needs to be reduced by a further £200,000 in order to maximise the available RNRB relief.

C1. Gift investments

Premium bonds and ISA account

Gifting the premium bonds and ISA will be PETs for CGT. As mentioned above, your limited lifespan means that your daughters will suffer an IHT charge at 40% based on their value at the date of gift.

However, as both of these assets are exempt from CGT, you can pass a further £125,000 to your daughters free of CGT.

Recommendation

I would recommend that the premium bonds and ISA are gifted to your daughters as soon as is practicable as a further means of reducing your estate.

C2. Stocks and shares

Again, any gift of stocks and shares to your daughters would be a PET for IHT purposes.

The shares appear to be standing at significant gains. You have an annual CGT exemption of £12,300 which currently does not appear to be being used,.

Accordingly, if shares are to be transferred as part of the exercise to reduce your estate, consideration should be given to cherry-picking those shares standing at the lowest gains or even at a loss.

Current year gains and losses are offset against each other. Cherry-picking the shares to limit the net gain to £12,300 would enable assets to be removed from the estate free of CGT.

Your financial adviser can assist in identifying the appropriate shares.

I will therefore assume that £75,000 can be gifted to your daughters and removed from the estate.

Recommendation

It is recommended that the balance of the estate reduction be made by gifting shares. Depending on the level of gains, this may need to be done over 2 tax years to maximise the CGT annual exemption.

C3. Sundry options

Whilst I note that you are currently utilising your annual IHT exemption, as a general recommendation, you should look to maximise other IHT reliefs such as the small gifts relief. This allows you to give £250 per year to any number of people other than those benefitting from the annual exemption.

Moreover, whilst these matters cannot be engineered you could gift £5,000 should any of your daughters be getting married or £2,500 to any grandchild getting married.

Unfortunately, making gifts via the normal expenditure out of income exemption will not be available to you as you are aware of your impending death.

A final option would be to reduce your estate by simply spending your money on yourself. You should make sure that you do not purchase items likely to increase in value. If possible, travel would be a good option.

C4. Gifting assets to trust for your grandchildren

I note that you would prefer not to leave money to your grandchildren as you consider them insufficiently mature at present.

This could be overcome by leaving money to a discretionary trust for the benefit of your grandchildren. Your daughters could be trustees.

As beneficiaries, your grandchildren have no right to either income or capital from the trust. Anything they receive is at the discretion of the trustees.

However, I note your over-riding desire for equality between Charlotte and Susan. As Susan has no children, and could be

potentially adversely affected, we have not considered this option.

Summary

Appendix 2 shows the effects of the tax mitigation measures. Your IHT liability on death would be £660,000. An IHT saving of £290,000

Section D: Power of Attorney

I note that whilst you remain mentally capable, you are growing physically weaker.

If it is likely that you will need someone to act on your behalf, you should consider a power of attorney.

This is an arrangement in which you give someone else (your daughters) power to act on your behalf.

As you have full mental capacity, you can set this up.

The deed creating the power of attorney should be in writing. The powers that can be exercised on your behalf can be set out and, if necessary, limited by you.

Whilst we can give general advice on powers of attorney, we cannot draft legal documents. You will therefore need to contact your solicitor for this.

A power of Attorney is normally revoked when the person making it loses mental capacity.

Alternatively, a lasting power of attorney, which can cover both financial and/or health and care decisions is unaffected by the

loss of mental capacity.

Recommendation

In light of your failing health, you should consider granting a power of attorney in favour of your daughters.

Chartered Tax Advisers LLP

8 November 2021

APPENDIX 1 - Current IHT Position

	£
Rosewood Cottage	500,000
Beach View	600,000
Bank balances	865,000
Stocks and shares	610,000
ISA	75,000
Premium Bonds	<u>50,000</u>
Total	2,700,000
Less: Residential NRB - tapered to nil	0
Less: Nil Rate Band (NRB)	<u>(325,000)</u>
Taxable	<u>2,375,000</u>
IHT @ 40%	<u>950,000</u>

APPENDIX 2 - IHT Post Planning

	£
Rosewood Cottage	500,000
Beach View	600,000
Bank balances - net of gift	365,000
Stocks and shares	535,000
ISA - gifted	0
Premium Bonds - gifted	0
Total	2,000,000
Less: Residential NRB -	(350,000)
Less: NRB used on PETs	0
Taxable	1,650,000
IHT @ 40%	660,000