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Answer-to-Question- \_1\_

## **Report**

**To: the Trustees of the Susan Wood Will Trust**

**From: Chris Photi, Tax Advisers**

**Date: 17 November 2024**

**Subject: Proposed restructure and distributions from the Susan Wood Will Trust**

This report is made to the above trustees following their telephone call of 10 November 2024.

The report is solely for the use of the above trustees. We bear no responsibility for its use and reliance on thereafter, by any other party.

This report is based on current tax legislation in place, although we have highlighted where we are aware that there are proposed changes. We have not included any impact of any changes not yet enacted and you may wish to seek further advice to update this report if and when they are.

This report is intended to cover options and implication in relation to the proposed distributions to Shaun Wood, the potential restructure of the trust and subsequent impact on Paul Wood's personal death estate.

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### **Executive Summary**

- - The Trust's assets are currently all held on a QIIP for Paul which means they are included in his death estate for IHT. When Paul gives this life interest up, it will trigger a CLT for Paul and lifetime IHT of £50,800 will become due. Assuming this is enacted on 1 February 2025, the IHT will be due by the trustees on 31 August 2025. There would also be additional IHT to pay if Paul dies within 7 years of this gift.

- The impact of this proposed CLT will be a reduction in Paul's estate for IHT and the trust's assets remaining will enter the relevant property regime. This will mean there is a ten yearly charge to IHT on the trust's assets at a maximum of 6%.

- In light of this, the assets left in trust should consist of those attracting more IHT relief as it is unlikely we will be looking at the 40% IHT charge in Shaun's death estate for a number of years, given his age.

- The trustees should distribute Fairview to Shaun on his 30th birthday in February 2025.

This will lead to a CGT charge of £308,800, payable by 31 January 2026 but will mean that Paul has a lower value of chargeable assets in his estate and the trustees will be liable to lower IHT charges when the remaining asset, Beach Farm, enters the relevant property regime when it is held on trust for Rebecca.

- Shaun should consider whether life insurance to cover any IHT liabilities in the event of his untimely death would be sensible. Fairview has no available relief from IHT in its current use and the exposure to IHT would be £1,590,000. Shaun could consider how to attract IHT reliefs on this to mitigate the future IHT due or by replacing the property with an asset which does attract relief.

- Sunnyside should be appointed out to Paul absolutely so that he can utilise both his and Anna's RNRB on his death when passing the property to Poppy. This would leave to a saving of £140,000 of IHT on Paul's death. There are no IHT implications for this appointment from the trust as the asset is already within Paul's death estate for IHT and the CGT gain on the disposal for the trustees will be covered by PRR.

- Paul should consider maximising his own lifetime gifting, by using his annual exemption and also making gifts out of surplus income (if applicable). He should also consider a letter of wishes to guide his executors and Poppy in the event of his early death.

- Once the above proposals are enacted, there will be a cash balance of £105,400 and Beach Farm remaining in the trust. Beach Farm will be held on the Discretionary Fund for Rebecca and the relevant deeds drawn up by the trustees' solicitors to document this. There will be ongoing ten yearly charges to IHT of around £11,000 (depending on current reliefs), which will be payable in instalments. The trustees expect that the cash balance will be used up in a few years which will leave only the Discretionary Fund. The trustees

should ensure that the trust's accounts show a clear record of the funds and their balances.

- The trustees intend to retain wider power of discretion on the remaining trust Fund which will allow them the flexibility to adapt to the changing needs of the beneficiaries.

- The availability of IHT reliefs on Beach Farm should be monitored over the next few years in light of recently announced proposed changes by the new Government. This report does not include the impact of those changes.

### **A - Current structure of the Trust**

The trust is currently a Qualifying Interest in Possession (QIIP) for Paul and he is entitled to all of the income of the assets within the trust. From Susan's letter of wishes, it is clear there were two assets which were earmarked in her estate for Shaun and Rebecca - Beach Farm and Fairview, with the remainder of the estate earmarked for Paul or his daughter, Poppy. Although the trustees are not bound by this letter, it gives some guidance as to how the estate can be divided and Susan's intentions. We note there is no need to achieve complete parity between Shaun and Rebecca so the below advice is provided on this basis.

As a QIIP trust, when Paul gives up his right to the income from an asset by virtue of it being appointed out of trust to another beneficiary, this is a potentially exempt transfer ("PET") out of his estate. If the asset remains in trust but is moved out of Paul's QIIP into a separate discretionary fund, this is treated as a chargeable lifetime transfer (CLT) by Paul and that part of the trust fund will be under the relevant property regime from then on.

The relevant property regime means that the trust is liable to an IHT charge every 10 years of up to 6% on the IHT chargeable value of its assets. Currently under the QIIP position, the assets are within Paul's estate for IHT but the PET or CLT route would remove them from Paul's estate and thereafter they would either be in Shaun's estate or within the relevant property regime for the trust.

The principal charge every ten years is payable in annual instalments for qualifying assets. Qualifying assets are land and property and some investments, so the Will Trust will be eligible to pay instalments on any assets in this regime except the cash held.

Once assets are within the relevant property regime in a discretionary fund, there would also be an exit charge for IHT if those assets were to be appointed out absolutely to a beneficiary.

For the purposes of the distribution to Shaun, we are working on the assumption that the trustees are looking to distribute out the asset absolutely as there is little benefit to retaining the asset in trust for Shaun so the below advice is based on this assumption.

### **B - Distributions to Shaun Wood**

The trust has two properties which are being considered for distribution to Shaun. Fairview, which is a commercial let property and Beach Farm which is a mixed use farm including 1 cottage occupied by a agricultural worker and 1 furnished holiday let cottage. We will consider each asset in turn.

The appointing out of either property will result in a disposal for CGT purposes for the trustees. There may be reliefs available which we will detail further below.

The other tax to consider is SDLT which is charged to the purchaser. As there is no consideration for the assets (i.e. Shaun is not paying anything) there is unlikely to be any SDLT to pay on these transfers.

### **1. Fairview**

If Fairview is to be appointed out of the trust to Shaun absolutely, there would be CGT for the trustees of £308,800 due (appendix 1). There would be no immediate charge to IHT and the assets is not a business asset so there would be no opportunity to holdover this CGT due and it would be payable by 31 January following the end of the tax year it occurs within. The disposal would be reportable on the trustees' self assessment tax return.

Shaun would hold the asset at its market value (£4,300,000) for his base cost which would mean that if he were to sell it in future, the CGT payable would be lower than with Beach Farm which would have a lower base cost based on the holdover relief explained below.

The distribution would also be a PET for Paul, as explained in section A, which means that there would be IHT at 40% to pay if Paul were to die within 7 years of the distribution. This would be tapered if Paul survives at least 3 years from the date of the distribution.

### **2. Beach Farm**

The distribution of Beach Farm would give rise to a chargeable gain on the trustees of £1,619,000, however, the trustees would be able to holdover this gain as the assets are qualifying business assets. Under s.165, the furnished holiday let and the arable land and buildings used in the trade would qualify as business assets and therefore the trustees could holdover this gain, with Shaun's agreement. The effect of this would be to pass the trustees' original base cost to Shaun, rather than the market value.

If Shaun were to sell the property in future years, this would lead to him having a higher CGT liability under this election.

In addition, the value of the PET for Shaun would be lower which would leave the trustees exposed to lower IHT in the event of Paul dying within seven years.

### **Conclusion**

From the immediate charge to tax, the distribution of Beach Farm to Shaun gives a nil CGT liability versus the distribution of Fairview which leaves the trustees liable to a CGT charge of £308,800 in the 24/25 tax year.

However, the wider consideration is that the remaining asset which will be left in trust is expected to move to a discretionary fund, held for Rebecca. This means that it will be included in the relevant property regime and chargeable to IHT at 6% every 10 years.

As Beach Farm has APR available to reduce the chargeable value and Paul is likely to survive the 7 year period after the date of the gift, we recommend that it is Fairview which is distributed to Shaun on his birthday in February 2025.

The impact on Shaun's IHT estate is that he will hold a higher value asset for IHT



purposes but there is no immediate charge to IHT in his hands (unlike in the Discretionary Fund for Rebecca) and, given his age, this is unlikely to be an issue for a long time. Shaun could consider life insurance against the cost of the IHT in the event of his untimely death as the cost is unlikely to be significant at this stage in his life. The potential IHT at stake is £1,590,000 on Fairview, given its current value.

Shaun has the opportunity to consider whether to sell the property and replace with a business asset which attracts IHT relief or to restructure the holding of the asset in a more tax efficient manner of his IHT estate but this is outside the scope of this report. Shaun's age, however, means that there is unlikely to be an immediate charge to IHT, unlike for the trustees.

The impact of the discretionary Fund for Rebecca is explained further in section D of this report.

### **C - Sunnyside & Paul's estate for IHT**

The current position for Paul is that the entirety of the trust Fund from the Will Trust is within his estate for IHT. This means that on his death, the trustees are liable for IHT of £2,235,758 (appendix 2). The assets will then also pass into the relevant property regime as the trust fund becomes entirely discretionary and IHT will be due every 10 years at 6%.

Paul is currently unable to utilise his Residents Nil Raste Band (RNRB) for IHT which reduces the chargeable value of his main residence by £175,000 on his death. This band is available when the main residence, held by the deceased, is passed to a lineal descendant.

It is tapered down to nil for estates with a gross value over £2m. In addition, Paul would be able to make use of Anna's unused RNRB which would increase the value of this relief to £350k. Paul does not currently hold his main residence personally as it is in trust so the RNRB is unavailable. In addition, his current IHT estate is currently valued at £6.6m and therefore the band will be tapered to nil.

Given the value of this relief and the planned changes to the trust which will reduce the value of Paul's estate to less than £2m, we suggest it would be best to ensure that the RNRB is available to Paul which means appointing it out to Paul absolutely.

Paul intends to continue living in the property so there is no possibility of giving the property away early to Poppy unless he also intends to pay Poppy a market value rent for continuing to occupy the property. HMRC has anti avoidance legislation which is designed to catch gifts where there is a reservation of benefit (i.e. giving away a property but continuing to live there rent free). In this case, the gift would essentially fail and the asset would remain in Paul's estate for IHT.

RNRB cannot be used during lifetime so if the property were given away to Poppy, this would also not be utilised.

The other option is for the property to remain in trust and pass to Poppy when Paul dies which again would not utilise the RNRB.

Our suggestion is that the relief of £350,000 offered by the RNRB is substantive enough to make the appointment of Sunnywide to Paul absolutely the best option. This relief would save £140,000 of IHT at 40%.

The appointment out of the property to Paul will be a disposal for CGT in the hands of

the trustees. However, as Sunnyside has been occupied by Paul, the life tenant of the trust, for the period of ownership, full Private Residence Relief (PRR) is available on the gain which reduces it to nil in the trustees' hands. Paul will hold the property at its market value on transfer (£850k).

With the proposed distributions to Shaun and appointment to the discretionary fund of the two most valuable assets in the trust, Paul's settled estate value will decrease to nil and all his assets will be held in his free estate. His IHT exposure, assuming he lives more than 7 years from the February 2025, will reduce from £2,235,758 to £142,160 (appendix 3) - a saving of £2,093,598. This would reduce even further if the cash from the life interest trust is not appointed out to Paul but is used up by the time of his death.

### **Other suggestions**

Paul should ensure he maximise his lifetime gifting which will allow him to gift up to £3,000 per year exempt from IHT. Paul does not need the income from the trust which obviously will reduce following the distributions to Shaun and resucture of the trust anyway, but, if he still has excess income he can also give this away free from IHT. Gifts out of excess income need to be habitual and demonstrably out of surplus income (i.e. not having to sell investments to keep income levels up). These can be made direct to Poppy or Emily, perhaps into an ISA or tax efficient investment. Emily is now 18 so a junior ISA is not available.

Emily was 18 on 30 April 2024 and therefore can receive assets in her own right (without them being taxed on her mother). She is still young, however, and so Paul has the option of passing them to Poppy first or direct to Emily. As he is not keen to use a trust structure, those will be his only options although we can explore further whether a trust structure which, say, gives Emily the income and capital at set ages might be appropriate.

For now, Paul's Will will not cause any issues for his IHT estate and he can consider a letter of wishes to direct his executors and Poppy in the event he dies before re-drafting it to include gifts to Emily.

### **D - Structure of the Trust**

Following the above sections, the final beneficiary to consider is Rebecca. The trustees have mentioned they would like to retain the non distributed property for Rebecca (i.e. Fairview or Beach Farm) and that it should continue to be held in trust, rather than be appointed out to Rebecca absolutely.

If the above recommendations are followed, it is Beach Farm which will be left in trust for Rebecca and Paul will give up his QIIP on this asset. This will constitute a CLT for Paul and will mean the new Fund is in the relevant property regime and liable to 10 yearly IHT charges at a maximum of 6%.

The trustees have mentioned retaining this within the existing Discretionary Fund with the power to apply the asset for the benefit of the whole class of discretionary beneficiaries but it will be held primarily for Rebecca's benefit.

The trustees should take advice from their solicitors on the best way to do this, whether a deed of assignment should be drawn up by the solicitors to ensure that this is documented correctly and all intentions are clear without restricting the trustees' powers. We would also suggest ensuring that the trust's accounts are clear as to how the income and capital are applied for the asset, whether by including fund accounting to separate out the life interest cash from the discretionary fund.

We assume that a discretionary structure would be better than giving Rebecca a full entitlement to the income generated at this stage but the trustees should ensure that they have a wide range of powers to amend this as necessary and as Rebecca's personal circumstances may change.

Given the above proposals for distributing Sunnyside and Fairview absolutely to Paul and Shaun respectively, the only remaining asset within Paul's QIIP will be the remaining cash. As the trustees have indicated, this cash should be used to pay the lifetime IHT on the CLT from Paul and the CGT on the disposal of Fairview and will be reduced to £105,400 once these liabilities are paid.

The trustees have indicated that they will retain this cash on the life interest trust for now but they could also consider appointing this out to Paul absolutely and then winding up the Will Trust except for the Discretionary Fund for Rebecca.

The ongoing IHT liability for the trust will be a principal charge due every ten years from 8 June 2032. This will be at a maximum rate of 6% on the chargeable IHT value of the estate (i.e. after APR or other reliefs).

Paul will be the settlor of this trust under IHTA 1984 s.80 and therefore we will reference his available NRB when calculating the charge to IHT. An example is in appendix 5 and shows the principal charge every ten years would be £10,921 (as an indication, as there are assumptions being used to calculate this).

This charge would be far higher if the property in the Discretionary Fund was Fairview as the charge would be based on a chargeable value of £4,300,000 versus £585,000 for Beach Farm.

## Appendices

### Appendix 1

#### A. Distribution of Fairview

CGT

	£	
Market value/proceeds	4,300,000	
Base cost	(2,750,000)	
Gain on disposal	1,550,000	
Trustees' AE	(6,000)	
Chargeable gain	1,544,000	
CGt @ 20%	308,800	

Value of PET for Paul

	£	
Value of PET	4,300,000	
Less Pauls's AEs (N1)	(6,000)	
Net value of PET	4,294,000	
Less Paul's NRB	(325,000)	
Chargeable	3,969,000	
IHT at 40% - potential exposure	1,587,600	

N1: Paul would have to give the trustees permission to use his annual exemptions, assuming they have not already been utilised for 24/25 and 23/24 tax years

**B. Distribution of Beach Farm**

Beach Farm		£	
Long Field		2,700,000	
Barns		220,000	
Beach Cottage		300,000	
Bulls Paddock		740,000	
Red Cottage		215,000	
Total market value		4,175,000	
Base cost (N1)		(2,550,000)	
Gain		1,625,000	
AE		(6,000)	
Chargeable		1,619,000	
CGT @ 20%	1,460	292,000	
CGT @ 28%	(165-6 )	44,520	

Note: the two cottages are charged at 28% as residential property

N1: the base cost of the farm would be the probate value (MV)

		£	
Long Field		1,700,000	
Barns		100,000	
Beach Cottage		200,000	
Bulls Paddock		400,000	
Red Cottage		150,000	
Total		2,550,000	

Value of PET for Paul

		£	
Market value of gift		4,175,000	
Less APR (see workings in Appdx 2)		(3,590,000)	
Chargeable transfer		585,000	

Less AEs	(6,000)
Less NRB	(325,000)
Chargeable	254,000
Potential IHT at 40%	101,600

N1: Paul would have to give the trustees permission to use his annual exemptions, assuming they have not already been utilised for 24/25 and 23/24 tax years

## Appendix 2

### Paul's current IHT estate

	£
Free estate	400,000
Settled estate	6,200,000
Gross estate	6,600,000
Less NRB (N1)	(650,000)
Less RNRB (N2)	-
Chargeable estate pre distributions	5,950,000
IHT @ 40%	2,380,000

IHT payable by Executors =  $2,380,000 * 400/6600 = £144,242$

IHT payable by trustees =  $2,380,000 * 6200/6600 = £2,235,758$

N1: Paul has his whole NRB available currently as well as 100% of Anna's NRB as she did not use any of it at her death.  $200\% * £325k = £650k$

N2: the RNRB is available if Paul owns his main residence and his gross estate is less than £2m. He will also have Anna's RNRB to utilise so up to £350k, depending on his final estate.

N3: the pension lump sum is currently exempt for IHT (although with recent announcements in the Autumn 2024 budget, this might change).

### Value of settled estate before distributions



	£	£
Fairview		4,300,000
Beach Farm - Long Field	2,700,000	
Less APR (N1)	(2,450,000)	250,000
Barns	220,000	
Less APR (N1)	(220,000)	-
Beach Cottage	300,000	
Less APR (N1)	(300,000)	-
Bulls Paddock	740,000	
Less APR (N1)	(620,000)	120,000
Red Cottage (N2)		215,000
Beach Farm - total		585,000
Sunnyside		850,000
Cash		465,000
Total chargeable value of settled estate		6,200,000

N1: The Long Field at Beach Farm is in agricultural use and APR should be available on the land. It has been owned for more than 7 years and is let on a post 1995 lease so 100% APR is available but only on the agricultural value of the land. Likewise the barn and the cottage which are used for agricultural purposes. The land at Bulls Paddock is also let and is used for agricultural purposes so 100% APR is available on the agricultural value.

N2: There is no APR or BPR available on Red Cottage as a Furnished Holiday let

### Appendix 3

#### Value of settled estate after distributions to Shaun/Rebecca's fund

	£	
Sunnyside	850,000	
Cash	465,000	
Total	1,315,000	

#### Paul's proposed IHT estate, assuming Will Trust QIIP wound up

	£
Free estate	400,000
Sunnyside	850,000
Cash appointed from trust	105,400
Total estate	1,355,400
NRB	(650,000)
RNRB	(350,000)
Chargeable	355,400
IHT @ 40%	142,160

The above IHT is also assuming that Paul's NRB is reinstated in full after surviving 7 years from the CLT and PETs

#### Appendix 4

#### CLT on transfer to Discretionary Fund

	£
MV	4,175,000
Less APR	(3,590,000)
Chargeable value of CLT	585,000
Less AEs (N1)	(6,000)
Less Paul's NRB	(325,000)
Chargeable	254,000
IHT @ 20%	50,800

N1: Paul would have to give the trustees permission to use his annual exemptions, assuming they have not already been utilised for 24/25 and 23/24 tax years

#### Distribution of remaining cash to Paul would be:

	£
Cash held	465,000
Less CGT appdx 1	(308,800)
Less IHT appdx 4	(50,800)
Cash remaining	105,400

Note: no implication for IHT as already in Paul's estate for IHT and exempt from CGT as cash

## Appendix 5

### Example of IHT principal charge for new Discretionary Fund 8 June 2032

Assumptions:

CLT date of 1 February 2025

market values same as current with no accumulated income over 5 years

no change to APR eligibility

	£
Value of trust after APR	585,000
Settlor's NRB	(325,000)
Chargeable	260,000

Theoretical  $£260,000 * 20\% = 52,000$

Effective  $52/585 = 8.889\%$

Actual  $8.889\% * 30\% * 29/40 = 1.8669\%$

Principal charge =  $1.8669\% * 585,000 = £10,921$

No quarters from date entering RPR to TYC

$01/02/25 - 08/06/32 = 7 \text{ yrs} + 1 \text{ qtrs} = 29$