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

Answer-to-Question-_1_

Report

To: Julia Upton

From: Tony Jones - Tax Advisers

Subject: Your Estate and tax planning

Date: 9 November 2022

This report has been prepared for Julia Upton and is prepared in accordance with the information provided in your email dated 25 October 2022.

Only Julia Upton may rely on the information contained within this report and we accept no responsibility for any reliance placed on this report by other parties.

This report will cover the following:

SECTION A - Your Will

SECTION B - Inheritance Tax position and distribution of estate
on death

SECTION C - Sale of Lakeside Lodge

SECTION D - Lakeside Home Furnishings Ltd

The following abbreviations will be used throughout this report:

"IHT"	Inheritance Tax
"CGT"	Capital Gains Tax
"BPR"	Business Property Relief
"BADR"	Business Asset Disposal Relief
"PET"	Potentially Exempt Transfer
"QIIP"	Qualifying Interest In Possession
"NRB"	Nil Rate Band
"RNRB"	Residence Nil Rate Band
"LHF"	Lakeside Home Furnishings Ltd

EXECUTIVE SUMMARY

- You should arrange for a valid Will to be put in place as soon as possible, as this will ensure that your estate is distributed in accordance with your wishes.

- Jonathan should, on your death, be given a QIIP in your estate. This would allow him to benefit from the income arising from the Trust assets, and allow him to reside in the property following your death. This will not however, allow Jonathan to decide on the distribution of any of your assets following your death.

- On Jonathan's death, Edward and Lucy should be given their share of the Trust funds outright, as there are no concerns for them.

- Jacob's share of the Trust fund should be held under a further Trust, known as a Protective Trust. This will allow Jacob to benefit from the income of the Trust until such a time that the Trustees decide to terminate the Trust and appoint the assets to him.

- Emma's share of the Trust should be held under an Age 18 - 25 Trust. The Trust would be appointed to Emma in full on her 25th birthday, but until this date, she would not be entitled to any of either the capital or income from the Trust fund, and so the Trustees will be able to ensure that the funds are not used irresponsibly.

- The sale of Lakeside Lodge will give rise to a CGT liability of £32,473 on the sale, and this will need to be reported to, and paid to HMRC, within 30 days of the sale completion.

- PRR is available on the sale however this is restricted to only cover the period in which you had occupied the property.

- BPR is currently available on the value of your shareholding in LHF. No BPR is available on the Director's loan currently outstanding and this value will be subject to IHT on Jonathan's death.

- On the transfer of the shares in LHF to your children, you will be able to claim BPR so that no IHT is payable. Provided that the shares are retained by your children, no IHT would become payable in the event of your death within 7 years.

- Both BADR and holdover relief will be available on the transfer of the shares, and we would recommend that BADR is claimed, to ensure that lower gains arise on your children in the future.

SECTION A - Your Will

You have confirmed that you do not currently have a Will in place. At present, in the event of your death, your UK estate will pass under the laws of intestacy.

Currently, this would mean that Jonathan would be entitled to any personal possessions that you own, along with a legacy of

£250,000 plus interest which would run from your date of death, along with a 50% share of the residue.

The remaining 50% share in the residue would then be split equally between each Edward, Lucy, Jacob and Emma; in Emma's case, if you were to die before she has turned 18, her share would be held under a statutory trust (Bereaved Minor's Trust) until she has turned 18, at which point she would become entitled to her share absolutely.

IHT would be payable on the residue left to your children, after any available reliefs.

Each beneficiary would be entitled to these assets outright and there would be no control over whether these are then used sensibly, or is indeed in their best interests to receive these outright.

Given that you have stated how you wish any legacies to Jonathan, Jacob and Emma to be held, this would not allow the distribution of your estate to be effected as you wish.

We would therefore recommend that you arrange for a Will to be drawn up. We have set out in **Section B**, the recommended structure of the Will, to allow this to follow your wishes.

We are not able to prepare a Will for you and you will need to

Speak with a qualified solicitor; if you need any help, we can provide you with the contact details of some solicitors that are recommended by us.

To be valid, the Will must be made in writing, and be signed by yourself, in the presence of 2 witnesses, who must also sign the Will in your presence. The witnesses should not be anyone who you intend to benefit under the Will.

You should also consider who you wish to appoint as your Executors on your death. You could choose to appoint a solicitor, or, appoint Jonathan, Edward and Lucy, either on their own or alongside a solicitor.

The rest of this report will be based on you having a valid Will in place.

SECTION B - Inheritance Tax position and distribution of estate on death

(B1) - Will structure

To ensure that your estate is distributed in accordance with your wishes, we would recommend that Jonathan is given an Interest In Possession in your estate.

On Jonathan's death, your estate should then be distributed to Edward, Lucy, Jacob and Emma in equal shares.

We have expanded on the actual terms of each beneficiaries entitlement below.

Your Will only dictates the division of your own estate and if Jonathan were to make his own Will, this would have no affect on the distribution of your own.

(B2) - Jonathan and position on his death

Jonathan would receive a QIIP on your death. A QIIP is created where Jonathan will be entitled to only the income arising from the assets held within your estate at your date of death.

This would mean that, rather than Jonathan receiving the assets in his own name outright, he instead is treated as the Life Tenant of the Trust, and the Trustees would retain control over the property held; Trust property is defined as all of the assets held by the Trust, not specifically land or buildings.

Although the QIIP essentially gives a right to enjoy the income from the Trust property, this is also extended to your half share of your property, either Lakeside Lodge or any future property.

The terms of a QIIP would give Jonathan the right to reside in

the property. If you were to die prior to the sale of Lakeside Lodge, the Trustees, as owners of a 50% share, and Jonathan as the owner of the remaining 50%, would be able to proceed with a sale of Lakeside Lodge in the future, with the excess sale proceeds held on the Trust's share, after the purchase of a replacement property, being held as Trust funds.

The QIIP could be stated to continue for Jonathan's lifetime or, until an earlier event.

For example, if Jonathan were to remarry following your death, your Will could state the the Trust would come to an end on this date, and Jonathan would from then no longer be entitled to the Trust funds. At this time, the Trust funds would be distributed to your children as set out below.

If the Trust came to an end on Jonathan's death, the capital value of the Trust would at this point aggregate with Jonathan's own estate for IHT; for IHT purposes, Jonathan would be treated as owning the underlying capital value of the Trust property.

However, the actual creation of the QIIP, and on the basis that your full estate held at the date of your death will fall into the Trust, will be a fully exempt transfer to Jonathan, and no IHT would be payable on your death on your estate.

Transfers between spouses are exempt for IHT, regardless of

whether these happen during lifetime or on death.

Based on your current assets, and the notes you have provided for Jonathan's own assets, we have set out a calculation of the estimated IHT liability, in **Appendix 1**, that would arise at this time, based on current market values.

Please note that as Jonathan is not our client, this report and calculation should not be relied upon by him and he would need to instruct us separately if he wished to receive any advice about his own IHT position.

On Jonathan's death, assuming that he does not make any lifetime gifts which become chargeable on his death, his estate will have the benefit of 2 NRB's, for a total of £650,000.

As the transfer of the assets into the QIIP is an exempt transfer, your own NRB will not have been utilised, and this unused amount can be transferred over into Jonathan's estate.

Additionally, the RNRB will also be available where a qualifying residential interest is left to lineal descendants.

To be a qualifying interest, there must be a property held within the estate that has, at some point during your ownership, been your main residence, and this must be left to your children, grandchildren etc.

Although your share of the property will fall into the Trust, the RNRB will be available as the property will still be passing to your descendants on Jonathan's death.

As with the NRB, Jonathan's Executors will be able to claim a brought forward allowance, of the amount of RNRB that is unused on your death, to be available at that time.

The RNRB, including any brought forward allowance, is capped at the lower of the value of the qualifying property or the residential enhancement for the year, which is currently £175,000 each.

Based on Lakeside Lodge remaining in both your estate's, this would allow a RNRB of £350,000. However if Lakeside Lodge were to be sold and the smaller property purchased, the RNRB would be restricted to the lower of the property value, say £250,000.

Additionally, the RNRB would be tapered away if the value of Jonathan's net estate, before any BPR, exceeds £2million. Based on current values, this does not seem to apply but this would need to be carefully monitored, as the RNRB can be a valuable relief that should not be wasted if possible.

(B3) - Edward and Lucy

As you have not raised any concerns regarding how Edward or Lucy would use their own inheritance, we can see no problem with them both receiving their inheritance outright on Jonathan's death.

(B4) - Jacob

As you have confirmed that Jacob is currently struggling with a gambling addiction, and that you have both agreed that he should therefore not receive any inheritance until he is in a more stable position, Jacob should not inherit his share of the Trust outright.

Instead, Jacob's share should be held under a Protective Trust.

A Protective Trust will provide for Jacob to have a QIIP in his 1/4 share of the Trust.

Similar to the QIIP for Jonathan, Jacob would be entitled to the income arising from his share of the Trust during his lifetime.

However, a Protective Trust has, as its name suggests, protections in place to ensure that the Trust property cannot be used by Jacob detrimentally.

If, for example, while the Trust is held under the QIIP, Jacob were to try to sell his interest in the Trust for money to another person, this would cause the Trust to immediately revert

to a Discretionary Trust.

Under the Discretionary Trust terms, Jacob would then only have a discretionary interest in the Trust, and so would only receive any income or capital from the Trust if the Trustees were to decide to appoint this to him.

For IHT purposes, the value of the Trust, regardless of whether a QIIP or a Discretionary fund would, as with Jonathan, aggregate with Jacob's estate on his death.

However, as you have confirmed that you would like Jacob to receive his share once he is recovering from, and managing his addiction, the Trustees would also have the option to bring the QIIP to an end during Jacob's lifetime, if they are satisfied that he would be able to deal with the funds sensibly.

A lifetime cessation of a QIIP would have no effect for IHT purposes, as under the QIIP Jonathan is treated as owning the capital value, and if the assets were to be appointed to him outright, he would then from this date own the assets in his own name and these would fall into his estate directly from this date.

The lifetime cessation is therefore a neutral transfer for IHT.

The appointment of the assets to Jacob by the Trustees would also

be a disposal for CGT. The Trustees would have received all of the chargeable assets, i.e. property, shares, at their probate value on Jonathan's death.

Where there is any increase in these values, the gain will be subject to CGT at either 28% for residential property, or 20% for all other assets.

The Trustees would be liable to settle the CGT liabilities arising at this time and there would be no option to claim holdover relief as the appointment will not be a chargeable event for IHT.

(B5) - Emma

Although you have no immediate concerns for Emma, the only difficulty is that she is currently a minor and so you are unsure how responsible she will be in the future.

You have stated that you wish for Emma to receive her own inheritance at an age no earlier than 25.

For this reason, on Jonathan's death, Emma's share of the Trust should be held under an Age 18 - 25 Trust.

The terms of an 18 - 25 Trust should state that on Emma attaining the age of 25, she is then entitled to receive the value of the

Trust outright.

Until this time, the Trust itself would be held as a Discretionary Trust, with any income arising from it taxed initially at the basic rates of 20% for non-savings and interest and 7.5% for dividends, with any income over this amount taxed at 45% and 38.1% respectively.

Until Emma turns 25, the Trustees could distribute the income arising within the Trust to her each year. Assuming that Emma is a non or basic rate taxpayer, she would be entitled to reclaim an amount of the income tax paid by the Trustees, as any income distributions are received net of a 45% tax credit.

This could mean that Emma could reclaim either all of the Trust tax paid, or if a basic rate taxpayer, either 25% or 30.6% of the tax, depending on whether this was non-savings/interest or dividend income.

The Trustees would need to ensure that sufficient income tax has been paid by the Trust each year to allow Emma to reclaim these amounts.

The Trustees could also appoint the lower of £3,000 or 3% of the Trust value for Emma's benefit each year, without this affecting the Trust position.

On Emma turning 25, this will be a chargeable event for IHT and an exit charge will arise at this date.

The exit charge will be calculated using the initial value of the Trust fund, less any remaining NRB from yourself, reduced by any lifetime transfers.

The rate of tax applying cannot exceed 6%, and will itself be determined by the number of completed quarters between the later of the Trust creation date and Emma turning 28; the quarters will therefore not exceed 28.

This would give a maximum rate of tax applying of 1.26%, which would be applied to the value of the funds being appointed to Emma, although BPR will be available to reduce the value of the Lakeside Home Furnishings shares, if these are still held by the Trust.

Additionally, on Emma turning 25 a disposal will arise for CGT, based on the increase in value on the assets from the date of the Trust creation.

However, as the appointment of the assets to Emma will be a chargeable event for IHT, the Trustees would be able to claim for holdover relief to apply, and this will defer the gain arising to the Trustees and deduct this instead against the base cost for Emma.

This will mean that Emma has a higher capital gain arising in the future however she will also have a higher annual exempt amount for CGT and may be liable to CGT at the lower rates.

Emma will also be able to increase her own base cost of the chargeable assets by the IHT paid on the appointment to her, regardless of whether a holdover relief claim is made.

Summary

To ensure that your estate is distributed in accordance with your wishes, we would recommend that your Will is structured as we have set out above.

This will ensure that Jonathan can benefit, and maintain his current lifestyle following your death, but will also ensure that Jacob and Emma's eventual entitlements are protected until they are both in more stable positions.

SECTION C - Sale of Lakeside Lodge

You have confirmed that Lakeside Lodge is to be sold in August next year.

Based on the current market value, we have calculated that you

will have a CGT liability of £32,473 arising, as set out in **Appendix 2**.

There is a capital gain of £407,500 arising on the sale, however, not all of this is subject to tax.

Firstly, your own base cost of £85,000, being the probate value of the property, will have been reduced on the transfer of the half share to Jonathan.

The transfer itself will have been an exempt transfer for CGT, as this was between spouses, however, Jonathan will have received a 50% share of your original cost and will also have inherited your ownership position for PRR from August 1990 - 1993.

As you have resided in the property as your main residence, you will be entitled to claim PRR on the sale. PRR is a relief available to people who sell their main residence, and essentially works to remove any of the gain that has arisen during the time in which you also occupied the property.

However, as you have confirmed that you did not occupy the property between August 1990 - August 1998, the gain arising during this time will remain subject to CGT.

You will be able to deduct your own annual exempt amount of £12,300, on the basis that this will not already have been

utilised, and the resulting gain will be taxable at 18%, up to the amount of basic rate band remaining, which we have taken to be the full amount as your salary will be covered by the personal allowance, with the balance taxed at 28%.

As you will have a CGT liability arising, you will be required to report the sale of the property to HMRC via their online UK property account, within 30 days of the sale completion taking place.

Additionally, payment of the CGT liability arising will also be due for payment within the same 30 days.

Where the sale has not been reported, or the liability paid to HMRC in the 30 days, interest and penalties will be applied.

We will be able to deal with this on your behalf if you so wish and we would recommend that you ensure that this is dealt with within the 30 day timeframe.

SECTION D - Lakeside Home Furnishings Ltd

(D1) - Inheritance Tax position

It would appear that LHF currently satisfies the definition of a trading company, as it is carrying out a qualifying trade that

does not appear to comprise of any investment activities.

On this basis, BPR will be available for IHT. BPR works to exempt the value of qualifying business property from IHT.

Qualifying business property generally means any number of shares in an unquoted trading company, a sole-trade or partnership interest, a controlling holding (more than 50%) in a quoted company, or assets owned by an individual which are used within a company that their either own or have a partnership interest.

The rate of relief applying is either 100%, for unquoted share holdings and sole-trade/partnerships, with 50% applying otherwise.

The asset must also have been held for at least 2 years prior to the chargeable event for IHT.

On our calculation of the IHT payable on Jonathan's death, we have therefore shown that the full value of the LHF shareholding will be eligible for relief at 100%.

This is on the basis that the Trustees of the QIIP will have retained the shares at Jonathan's date of death. If the shares have been sold then no relief would be available, unless the proceeds were reinvested fully into other property qualifying for BPR within 2 years of the sale.

If Jonathan were to die within 2 years of your own death, BPR would still be available on the retained shares, even if the Trust has not held the shares for 2 years, as an election can be made to aggregate the Trust's ownership period with your own.

BPR will be restricted where a company holds excepted assets. An excepted asset is generally deemed to be an asset which has not been used within the business at any time during the previous 2 years and is not needed for future business use.

Specifically, a Director's loan will be an excepted asset, as it is treated as cash held by you, as you are able to call on this amount to be repaid at any time, and you can essentially treat the loan as a bank account within the company, and is therefore not an asset that is being used for business purposes.

On your death, the loan would need to be repaid by the company at this date.

No BPR will be available on this amount and so the full value of £200,000 will be subject to IHT.

If instead you were to request that the loan is repaid, this would then allow BPR to be claimed on the company value in full, although the cash then held within your estate would be subject to IHT.

You could then reinvest these funds into qualifying business property, i.e. by purchasing AIM quoted shares, then, once these have been held for 2 years, these will also be eligible for BPR, and would reduce the IHT eventually becoming payable, by £80,000.

As you have confirmed that you have no health concerns at present, it is likely that the ownership period for BPR would be met on the reinvestment of the funds and would mean that IHT of £80,000 is saved when the QIIP comes to an end.

(D2) - Transfer of shares to children

As the shares themselves are eligible for BPR in full, then shares can be gifted to your children free of IHT during your lifetime. We have set out the below on the basis that neither Jacob nor Emma will receive shares in the company until such time that they are determined as being able to receive the shares with no adverse effects.

The transfers will be valued based on the loss to your estate on each transfer, being the reduction in your 100% holding, although as you will retain a controlling holding in the company, this should not be too substantial.

The transfers will be PET's for IHT. A PET is a transfer which would only be come chargeable to IHT in the event of your death

within 7 years. The value of the PET would be Nil, based on BPR being claimed, and provided that the shares were still retained by the individual at the date of your death, then BPR will not be withdrawn at this time and no IHT will become payable.

Where any of the children have not retained the shares, then the BPR will be withdrawn, either fully or partially depending on whether any of the shares have been retained, and any IHT becoming due would be payable by them.

Taper relief would be available to reduce the IHT payable, at 20% per year, once more than 3 years have passed between the transfer of the shares and your death.

Additionally, the transfer of the shares by you will be a disposal for CGT, based on the current market value and your own original cost. For example, a transfer of a 5% shareholding would give rise to a capital gain of $(35,000 - 5) \text{ } \pounds 34,995$.

You would be liable to pay any CGT arising at this time, after deducting any annual exempt amount you have available, with the gain being taxed at 10% or 20%, depending on how much falls into your basic rate band.

However, there are 2 reliefs that could be claimed.

Firstly, holdover relief could be claimed to remove any capital

gain arising to you and deduct this against the base cost of the shares for the new shareholder.

Holdover relief will be available as you will have transferred a qualifying business asset for CGT. The effect of the relief would be to defer the gain arising until such time that the new shareholder disposes of the shares.

Alternatively, if you did not wish to leave your children with higher gains in the future, you could instead make a claim for BADR to apply.

BADR is available on a material disposal of your personal trading company, being where at least a 5% shareholding is disposed of.

A personal trading company is one in which you hold at least 5% of the ordinary shares, along with 5% of the voting rights, and are entitled to either 5% of the distributable profits or assets on a winding up of the company, or 5% of the ordinary share capital.

You must also have worked for the company for at least the 2 years prior to the disposal.

Your own shareholding will therefore qualify for BADR when transfers are made. BADR will leave the gain arising liable to CGT, however this will be taxed at the flat rate of 10%, subject

to the gains during your lifetime not exceeding the limit of £1million.

This would mean that, although you would have a CGT liability arising on each transfer, this would be at the lower rate and would mean that your children will receive the shares with a base cost equal to their current market value.

This may be beneficial as your children would not be entitled to claim for BADR on future sales, if they do not work for the company; A BADR claim can only be made by Directors or employees of a company.

To enable BADR to be available on the sale of the shares by your children, you could request that, on the transfer of the shares, they are each appointed as a Director of the company.

If the shares are held by the Trustees of the QIIP at this time, as they will be the owners of the company, they would also be able to appoint Directors.

Provided that they have been a Director for 2 years when the shares are sold, and they still hold a 5% shareholding, this would mean that BADR would also be available on the future disposals.

If it would not be possible for your children to be appointed as

Directors, then we would recommend that you do not claim holdover relief on the transfer of any shares, as this will leave them each with a higher base cost, and reduce the tax payable by them in the future.

Do note though that once the QIIP has come to an end, each Edward, Lucy, Jacob and Emma will receive a 25% shareholding, either outright or in the future from their own Trusts, if the 5% holdings have not already been transferred prior to this.

Provided that you do not receive any consideration from your children for the shares, then there will be no Stamp Duty implications.

Appendices

Appendix 1 - IHT on Jonathan's death

QIIP assets:			
Lakeside Lodge		450,000	
UK current account		10,000	
UK savings account		40,000	
Stocks and Shares ISA		90,000	
Shareholding Lakeside Home Furnishings	700,000		
Less: BPR x 100%	<u>(700,000)</u>		

		-	
Directors Loan/Cash		<u>200,000</u>	
			790,000
Jonathan's free estate:			
Lakeside Lodge			450,000
UK current account			10,000
UK savings account			<u>40,000</u>
Total estate			1,290,000
Less: RNRB			(350,000)
Less: NRB			<u>(650,000)</u>
Taxable estate			290,000
IHT x 40%			116,000
Payable by:			
Executors	116,000 x 500,000 / 1,290,000	44,961	
Trustees	116,000 x 790,000 / 1,290,000	<u>71,039</u>	
		116,000	

Each beneficiary of the Trust would therefore receive a net legacy, before BPR, of £1,961,000.

Pension funds are not subject to IHT on the basis that the payments made on death will be at the discretion of the pension trustees. If any amount is due to estate by right, then the above pension values would need to be included and revised calculations produced.

Appendix 2 - Sale of Lakeside Lodge

Market value (1/2 share)		450,000	
Less: Cost	(85,000 x 1 / 2)	<u>(42,500)</u>	
Capital gain		407,500	
Less: PRR (below)	407,500 x 15 / 23	<u>(265,761)</u>	

Chargeable gain		141,739	
Less: AEA		<u>(12,300)</u>	
Taxable gain		129,439	
CGT x 18%	37,700 x 18%	6,786	
CGT x 28((129,439 - 37,700) x 28%	<u>25,687</u>	
		32,473	

Private Residence Relief:

	Occupation (years)	Absence (years)	Total
August 1990 - August 1998		8	8
August 1998 - August 2023	<u>15</u>		<u>15</u>
	15	8	23