

# **The Chartered Institute of Taxation**

**Application and Professional Skills**

**Inheritance Tax, Trusts & Estates**

**November 2021**

**Suggested solution**

## **REPORT TO EMILY TAYLOR**

### **INTRODUCTION**

Further to your email of 1 November 2021, this report will consider:

- 1) The implications of your proposed gift of 49 Beach View to your two daughters
- 2) The implications of your proposed cash gifts of £250,000 to each of your children
- 3) The best way for you to gift £50,000 to your local Hospice
- 4) Other steps that may be taken to mitigate your tax exposure

This report will explain the implications and tax charges that will arise should your proposed plans be implemented. Explanations will also be provided for an alternative strategy that could be taken to achieve tax savings.

This report is based upon the information provided by you and the valuations provided by your Financial Adviser. This report assumes that the most recent valuations remain constant going forward.

### **EXECUTIVE SUMMARY**

A review of your estate indicates that your assets total £2.7 million. After provision for the available tax reliefs your Inheritance Tax (IHT) exposure amounts to £950,000. You want your assets to be split equally between your two daughters and your current Will does achieve this aim.

You were previously advised that gifting your furnished holiday let to your two daughters would be a good start in beginning to mitigate your Inheritance Tax exposure.

Given your current health situation it is likely that you will not survive seven years from the date of gift and so the gift will be bought back into charge for Inheritance Tax purposes. You will not therefore save any Inheritance Tax by making the gift. You will however increase the future Capital Gains Tax charge that will arise when your daughters sell the property.

The gift of this property should not take place and it should be allowed to pass to your two daughters via your Will.

You also wish to make cash gifts £250,000 to each of your two daughters as soon as possible to allow you to see them enjoy the money.

It is important that these gifts are either made on the same day or you will need to amend your Will to ensure each of your daughters inherits the same amount from you after tax.

If the gifts are not made on the same day the earlier gift will benefit from the available nil rate band and no additional tax upon death will be payable. The later gift will only benefit from the remaining nil rate band and will not be fully covered, resulting in £70,000 of IHT becoming payable.

If it is not possible to make the gifts to Charlotte and Susan on the same day, then an additional cash legacy should be left to Susan. This will pass free of tax equalising the overall estate distributions.

Currently, and even after the two gifts of £250,000 to each of your children, your estate will not qualify for the Residence Nil Rate Band (RNRB) or the Transferable Residence Nil Rate Band (TRNRB) relief in full. The maximum available relief is £350,000 but this is tapered when your estate is above £2 million. Your adjusted relief, after tapering, is £250,000.

If additional cash gifts are made to your daughters totalling £200,000 then this relief will revert to its maximum of £350,000 saving an additional £40,000 in IHT.

The proposed gift to your local Hospice should be made in your lifetime. You will then benefit from Income Tax savings associated with charitable gifting in your lifetime.

## **OVERVIEW OF SITUATION**

You have received news that your illness has returned. The doctors believe you have 12 – 18 months to live although you retain mental capacity.

A review of your estate shows that your assets are valued at £2.7 million which will give rise to a £950,000 IHT charge (see Appendix 1).

You have a valid Will which leaves your estate equally between your two adult daughters in line with your current wishes.

Your estate will benefit from your Nil Rate Band (NRB) of £325,000 but your husband fully utilised his NRB on his death so there is none to be transferred.

Your estate does not qualify for the RNRB or TRNRB due to its value being more than the maximum limit.

Following previous advice, you are planning to transfer 49 Beach View to your two daughters in equal shares as soon as possible. Your daughters have indicated that they will not retain the property but rather they will seek to sell it in the short term.

You plan to gift £250,000 to each of your two daughters, Charlotte and Susan, as soon as possible. You want to do this to enable you to see them enjoy the money. Charlotte is very happy to accept but Susan is very upset and wants to delay accepting the gift until January 2022.

### **49 BEACH VIEW**

This property is a qualifying Furnished Holiday Let (FHL).

This has several tax consequences. The key significance in your scenario is the Capital Gains Tax (CGT) consequences of owning an FHL. For CGT purposes the asset is treated in the same way as a business asset.

The proposed lifetime gift to your two daughters will result in a taxable gain of £40,770 (see Appendix 2). You and your daughters are connected for CGT purposes and so the tax is based upon open market values rather than actual consideration. This is the reason why the gift still gives rise to a tax charge. The tax rate applied to this gain is 10% as you are likely to qualify for Business Asset Disposal Relief. This relief is available where business assets are disposed of which you have held for more than two years. The only condition that we need to double check is that you have not already used your lifetime limit for Business Asset Disposal Relief which stands at a maximum £1 million.

An election can be made to hold-over this gain which is possible because the FHL is treated a business asset. The election will mean that your daughters acquire their respective shares of the property at a CGT base cost equal to your cost figure and no CGT will be payable by you.

Given that your daughters wish to sell the property in the near future and considering your illness returning, this gift is unlikely to be tax efficient.

Although an FHL has beneficial tax treatment for Income Tax and CGT purposes it does not benefit from any relief from IHT. There have been several high-profile cases testing whether the letting of an FHL can qualify for IHT relief in the form of Business Property Relief.

It has been established that the income from services relating to the holiday (food hampers, guided walks, laundry etc.) should make up the majority of the business rather than the underlying rental for

the property. It is therefore highly unlikely that your FHL will qualify for Business Property Relief given the low level of services you are offering.

With this being the case if you proceed with the lifetime gift of the property to your daughters there will be a double tax charge to both IHT (on your death) and CGT (at time of gift).

The gift of the property to your daughters will be a Potentially Exempt Transfer (PET) for IHT purposes. Unfortunately, we know that this gift is likely to fall within seven years of your death given your current circumstances. This will mean that the gift will fall back into charge for IHT purposes. No IHT savings will therefore be achieved by making the gift.

From a CGT perspective, if the property is gifted to your daughters and, as expected, they choose to sell the property in the near future, they will have a significant CGT charge.

If you and your daughters choose to make the hold-over election noted above, they will have obtained the property at your cost figure being £180,000. As higher rate taxpayers, their combined CGT liabilities will be £110,712 (See Appendix 3). Your daughters will not qualify for Business Asset Disposal Relief and the 10% tax rate, as they will not have owned the property for more than two years. Their tax rate will revert to the residential property CGT rate of 28%.

If the property is not gifted to your daughters and instead forms part of your estate upon death, then it will benefit from a CGT uplift to its market value on your death. Under the terms of your current Will the property will fall into the residue of the estate and pass equally to your two daughters.

Your daughters will acquire the property at a CGT base cost equal to the probate valuation which, assuming no change in the market value, will be £600,000. This means that upon later sale there will be no capital gain and no CGT to pay assuming the property has not increased in value by the date of sale. There will therefore be no double tax charge.

We recommend that the lifetime gift of 49 Beach View does not take place. This asset should be left to pass via your Will to ensure that there is not a double tax charge to both IHT and CGT. The terms of your current Will can remain unchanged.

### **PLAN TO GIFT £250,000 TO CHARLOTTE AND SUSAN**

Turning to your proposed cash gift of £250,000 each to Charlotte and Susan. When considering this proposal, we need to consider the interaction of the available nil rate band with gifts made in the seven years prior to death.

The gifts will be PETs for IHT purposes. Unfortunately, we know that these gifts are likely to fall within seven years of your death and this will mean that the gifts will fall back into charge for IHT purposes. No IHT savings will ultimately be achieved by making the gifts but there is no tax disadvantage either. We do not need to consider CGT, as cash is not a chargeable asset for CGT purposes. We know the reason for the gifts are so that you can see your family enjoy the money during your lifetime, so the lack of tax saving is not significant.

The timing of the gifts is crucial as your available nil rate band will be allocated to older gifts first. If you are to gift £250,000 to Charlotte in the coming days but wait until January 2022 to make the gift to Susan, then your desire for equality between your two children will be impacted.

The gift to Charlotte will be fully covered by the nil rate band resulting in no additional tax being due from her. The remaining £75,000 of nil rate band will be allocated to the later gift to Susan but this will leave £175,000 exposed to 40% IHT resulting in £70,000 of tax payable by Susan.

To ensure that this inequality does not occur, the gifts to Charlotte and Susan should be made on the same day. This will ensure that the available nil rate band is shared equally between the gifts to Charlotte and Susan when they become chargeable.

If it is not possible to make these gifts on the same day, then you will need to change the terms of your Will to ensure the inequality is dealt with. If you do not wish to delay Charlotte's gift until the New Year, the easiest way to achieve the desired outcome is to leave a specific legacy of £70,000 to Susan which

is equal to the tax payable as a result of her lifetime gift. This cash legacy will be paid to Charlotte without deduction of any IHT on death and so equality between the two daughters will return.

We recommend that the two cash gifts are made on the same day to both of your daughters to ensure one does not pay more tax than the other. If it is not possible to make the gifts on the same day your Will requires amendment to ensure equality between the two daughters is maintained.

### **AN OPTION FOR INHERITANCE TAX MITIGATION**

As you are aware given your situation your options for IHT mitigation are limited.

Assuming our previous recommendation regarding 49 Beach View is followed, your estate will total assets of £2.2 million (£2.7 million - £500,000 gifts made).

This has implications for the availability of the Residence Nil Rate Band (RNRB). The RNRB is an additional nil rate band that can be used if qualifying conditions are met.

These conditions are:

1. The estate contains a "qualifying residential interest", which Rosewood Cottage is and
2. That residence is "closely inherited" which it will be as it is passing to your two daughters.

Importantly, this additional relief only applies in full to estates with gross assets of less than or equal to £2 million. Above this level the relief is restricted.

The relief is transferable between married couples upon death in line with the usual nil rate band. When your husband died the relief did not exist, but his unused relief still passes over to you.

The relief amounts to £175,000 of additional nil rate band for each individual so you have yours and your husband's relief totalling £350,000. This relief can only be utilised against the value of the residential property but your case this is not problem as your property is worth more than £350,000.

The relief is restricted by £1 for every £2 of gross estate value over £2 million. In this case the relief is restricted by £100,000 ( $\frac{£2,200,000 - £2,000,000}{2} = £100,000$ ). This leaves available relief of £250,000. However, if we can reduce your estate at the date of death to below £2 million then you will qualify for full unrestricted relief. This will save IHT of  $£100,000 \times 40\% = £40,000$ .

The easiest way to reduce your estate value at the date of death is to make a lifetime gift as such gifts are not included within the calculation. As in the case of 49 Beach View we must be careful not to create double tax charges to IHT and CGT and we should therefore use assets which are not chargeable to CGT.

As you have sufficient cash levels the easiest thing to do is to give an additional cash gift to Charlotte and Susan of at least £200,000. This will reduce your estate down to the £2 million limit and will increase the total cash gift to £700,000 (or £350,000 each). As always, the non-tax considerations of such a significant gift should be considered as well. You need to be confident that you still have sufficient liquid resources to maintain your standard of living and pay for any required care. You are able to access your premium bonds and ISA accounts without triggering any tax liabilities should this be necessary.

We recommend that the gift to Charlotte and Susan are increased to £700,000 from the current proposed level of £500,000. Once again, these gifts must be made at the same time to each daughter to ensure the IHT payable is apportioned equally. Increasing these gifts to this level will save £40,000 in IHT.

### **CHARITABLE GIVING**

Gifts to registered charities are exempt from Inheritance Tax. This means that if make the gift in your lifetime, this amount will not be brought back into charge should you not survive seven years from the date of gift. Alternatively, if you leave the gift via your Will, the amount equal to the gift is not chargeable to Inheritance Tax. In either circumstance, no Inheritance Tax arises on the amount of the gift. A gift of £50,000 would therefore save tax of £20,000 ( $£50,000 \times 40\%$ ).

It is possible, in certain circumstances, to obtain a reduction in the Inheritance Tax rate from 40% to 36% when gifts are made to charity via a Will. However, to obtain this relief you must leave at least 10% of your estate to charity. In your case the gift would need to be at least £200,000. This is assuming that the gifts to Charlotte and Susan and the additional cash gift of £200,000 have taken place leaving you with a gross estate of £2 million.

A gift of this size would reduce your Inheritance Tax liability by £138,000. The £200,000 charitable legacy is exempt from tax saving £80,000 (£200,000 x 40%). The remaining taxable estate of £1,450,000 (£2,000,000 - £200,000 charitable legacy - £350,000 RNRB) will be taxed at 36% not 40% saving £58,000. The net cost of the gift is still however £62,000 and therefore in excess of your desired £50,000 level.

If the gift is made during your lifetime you will be able to gift aid the donation which has tax saving implications for you. You can gift aid the donation as you pay more tax than the charity will reclaim.

When you gift aid a donation, your basic rate band is extended by the grossed up charitable donation. In your case this extension would mean your basic rate band would be extended by £62,500 (£50,000 x 100 / (100-20)). This would save you Income Tax at the marginal difference between basic rate and higher rates of tax. The charity you donate to will also be able to reclaim the gift aid element (£12,500) and so they will receive more in total.

We recommend that the gift to the hospice is made during your lifetime. This will allow you to benefit from Income Tax savings associated with gift aid donations, although this Income Tax saving will increase the level of cash your estate ultimately holds. Making the gift via your estate will not give rise to any Income Tax savings and the gift would need to be higher to allow for any Inheritance Tax savings over and above those you will already make from a lifetime gift.

## **CONCLUSION**

Although you have received news that your life expectancy is likely to be limited, it is possible to carry out your wishes and ensure that your daughters enjoy lifetime gifts while retaining equality.

Ideally, should Susan be willing, gifts of £250,000 should be made to each of your daughters on the same day. If made on the same day the tax burden will be split equally and due to the enhanced availability of the Residence Nil Rate Band an IHT saving of £40,000 will occur.

If Susan is unwilling to accept the gift until the 2022 New Year and you do not wish to delay Charlotte's gift then you will need to vary your Will to include an additional free of tax cash legacy to Susan to ensure the after tax estate distributions were equal.

You should not gift your furnished holiday let, 49 Beach View, to your daughters during your lifetime. This will result in a double tax charge with both IHT and CGT charges arising. This asset should be allowed to pass to your daughters via your Will whereby it will benefit from a tax-free uplift for CGT purposes reducing the future CGT payable.

The above steps will ensure that your estate passes to your daughters equally in line with your wishes. If the additional gift of £100,000 each is made to your daughters, additional tax savings of £40,000 will also be made.

## **Tax Advisers**

**5 November 2021**

## APPENDIX 1

### Summary of Estate and Inheritance Tax charge

	£	£
<b>Land and Property</b>		
Rosewood Cottage	500,000	
49 Beach View	600,000	
	<hr/>	<hr/>
	1,100,000	1,100,000
<b>Bank account balances</b>		
UK Current Account	45,000	
UK Savings Account	820,000	
	<hr/>	<hr/>
	845,000	845,000
<b>Investments</b>		
Stocks and Shares Main Account	610,000	
Stocks and Shares ISA	75,000	
National Savings	50,000	
	<hr/>	<hr/>
	735,000	735,000
Total assets		2,700,000
<b>Inheritance Tax Calculation</b>		
Total assets		2,700,000
Available Reliefs		
2021/22 Nil Rate Band	325,000	
Transferrable Nil Rate Band from Husband (Fully Utilised)	-	
Residence Nil Rate Band & Transferable Residence Nil Rate Band (Fully restricted)	-	
	<hr/>	<hr/>
	325,000	(325,000)
Taxable estate		2,375,000
Tax at 40%		950,000

## APPENDIX 2

### Capital Gains Tax Charge on 49 Beach View Gift – No Holdover election

	£
Connected parties so CGT based upon Market Value	
Market Value	600,000
Less: Cost	(180,000)
Chargeable Gain	<hr/> 420,000
Annual Exemption	(12,300)
Taxable Gain	407,700
Tax at 10%	40,770

## APPENDIX 3

### Capital Gains Tax Charge on Daughter's subsequent property disposal (assuming hold-over election is made)

	£
Sale Proceeds 50% share	300,000
Less: Cost 50% share	(90,000)
Chargeable Gain	210,000
Annual Exemption	(12,300)
Taxable Gain	197,700
Tax at 28%	55,356
Tax charge multiplied by two	110,712