

## **A variation using trusts (Lecture P1449 – 14.13 minutes)**

While it has always been tempting for married couples to rely on the spouse exemption in s.18 IHTA 1984 and leave everything (including relevant business property) to their other half on the first death, this strategy wastes a serious IHT planning opportunity which can result in the estates of both spouses being able to take advantage of 100% business relief on each of their deaths.

The potential for this double relief in the context of what some tax advisers call a 'two-fund will trust' is explained in the example which follows.

### *Example*

Chris (62) and Sarah (50) are a married couple. Chris has two children, a daughter, Chloë, from a previous marriage and a son, Andrew, with Sarah. Both children are unmarried – Chloë is aged 31 and Andrew is 25.

Chris owns all the shares in a successful trading company which he runs with Sarah and Andrew. As Chris' tax adviser, you have recently valued the company at £4,800,000 and your analysis of the business confirmed that the shares should be eligible for full relief.

In addition, Chris holds a substantial portfolio of quoted investments which are managed by his stockbroker and are worth another £4,800,000. The family home in Weybridge, which is in Chris' name, is worth £3,000,000.

Andrew still lives with his parents, but Chloë, who works in London, owns a flat of her own in Battersea.

Chris is keen to maximise the benefits of the various IHT reliefs, but, given the age differential, he wants to ensure that Sarah is well provided for after his death (should he die first). Eventually, he would like Chloë and Andrew to share his estate equally.

Our advice to Chris, when he rewrites his will, is to put in place a two-fund will trust in order to achieve these aims.

The will should leave the assets qualifying for 100% business relief (i.e. the shares in the trading company) into a fund of the trust which will be fully discretionary (Fund 1). The assets in Fund 1 will be held for the benefit of Sarah, Chloë and Andrew. Chris' personal representatives will of course be able to claim full IHT relief on these assets.

Chris' remaining assets should pass into a separate fund (Fund 2), in which Sarah has a life interest. As the sole life tenant, Sarah will be entitled to all the income arising in Fund 2 as well as the right to remain living in the family home. As mentioned above, she will also be a discretionary beneficiary of Fund 1.

One tax expert has described the benefits of this arrangement in these words:

'A key part of this (form of) planning is that the relievable and non-relievable assets are held within two funds of the same trust. This means (that), if appropriate to do so, the trustees can choose to exchange assets of equivalent value between the funds, without incurring a CGT or SDLT liability. If these assets were swapped, the

shares would subsequently be held of life interest trusts and the investments would be held on discretionary trusts.'

On the assumption that Sarah lives for at least two years after this rearrangement, the shares in Fund 2 will again qualify for 100% business relief. They can then either be held in that fund until Sarah's death or she might choose to make a gift of the shares. This gift would be free of tax as a PET if she survived a further seven years or, if she died sooner, the shares would presumably still qualify for the IHT relief. Regardless of whether the shares are retained or are gifted, there would be an IHT saving of £1,920,000 ( $40\% \times £4,800,000$ ), compared to the fund holding the quoted shares (Fund 1).

There will be no charge on Sarah's death on these investments, given that they will be held under the relevant property charging regime involving what is essentially a maximum tax charge of 0.6% for every 12-month period during which the investments stay in the trust.

After Sarah's death, the trustees may choose to keep the assets in the trust or alternatively to distribute them to Chloë and Andrew (or any grandchildren) in accordance with Chris' wishes. Flexibility has been built into the structure at every step of the way so that Chloë and Andrew can benefit from an equal share in each asset or the business assets could go to, say, Andrew, with the rest of the investments ending up with Chloë.

Note that there are no residence nil rate band considerations to think about here in view of the size of Chris' and Sarah's estates.

*Contributed By Robert Jamieson*