

Using a trust to reduce CGT

(Lecture P1100 - 17.54 minutes)

A trust could be used as a means to gifting an asset to another individual that would normally be chargeable to capital gains tax. The trust property can either stay in trust with the individual benefitting from a life interest, or the asset could ultimately be transferred out of the trust to the individual, absolutely.

Example

Bob wants to gift an investment property to his daughter. The property is valued at £325,000 with a base cost of £100,000. In making the gift directly to his daughter, Bob will be making a PET for inheritance tax (no problem so long as he survived the seven years etc) but the transfer will be a capital gains tax event and a potential 28% tax liability is due after the annual exemption etc.

By transferring the property into a trust, this will create a chargeable lifetime transfer for inheritance tax purposes – this is not a problem in this case as the nil rate band of £325,000 will cover this. Survive a further seven years, and Bob will receive a further nil rate band. The transfer of the property into the trust will be chargeable for capital gains tax, however a s260 IHTA 1984 deferral claim can be made to defer the gain to the trustees. In the future, the property can still be transferred on to the daughter, and a holdover claim can then be used again by the trustees, to defer the gain on to the daughter.

To hold a property and secure Principal Private Residence Relief

If a second property is required, but as a second property no principal private residence would be available, consider purchasing through a trust if a beneficiary is likely to live in the property.

Example

Mrs F would like to purchase a property for her daughter to live in while she is at university.

She has the following options:

Option one: purchase the property in her own name – thus increasing her own estate for inheritance tax purposes, should the property increase in value. If she is a high net worth individual, with exposure to IHT, she's also missing the trick of reducing her IHT exposure by not using an opportunity to make a transfer at the time of acquiring the property. She also has the income tax and capital gains tax effects of the property being in her ownership – higher rate tax on income maybe together with the lack of PPR on disposal.

Option two: gift either the cash to enable the daughter to purchase the property in her name, or in fact gift the property itself to the daughter. They may be gaining on the income tax advantage of using personal allowances and minimising higher rate taxes together with the capital gains tax advantages of the daughter achieving PPR relief on disposal of the property.

The value of the property in the daughter's estate also goes some way to reducing the parent's estate and using the daughter's own nil rate band. However, the legal ownership of the property in the daughter's name may put off many individuals from taking this option.

Option three: use a trust for ownership of the property. The trust will receive some income which will be taxed at the appropriate rate, but there is always the option to make income distributions to minimise unnecessary income tax. If the daughter resides in the property as their permanent residence, then as a qualifying beneficiary, PPR should be available. Finally, in creating the trust, together with any growth on the value of the property, the advantage is this will be outside everyone's estate from an IHT point of view and therefore tax efficient.

Contributed by Amanda Fisher