

Trusts for tax planning as well as practical purposes (Lecture P1094/ P1095 – 18.54/ 9.40 minutes)

Trusts and their uses - family provision and will planning for spouses

Transfers between spouses and civil partners – s18 IHTA 1984 - Transfers between spouses are exempt where they are direct transfers. This applies whether the transfer is made in lifetime or on death. The exceptions are where:

- The transfer takes effect on the termination, after transfer of any interest or period
- It depends upon a condition which is not satisfied within 12 months
- Transferor spouse/ civil partner is UK domiciled but transferee is non UK domiciled.

Transfer of a deceased spouse's unused nil rate band – s10 & Sch 4 FA 2008

Since 9 October 2007, it has been possible to transfer any balance of unused nil rate band (or the current £325,000 limit in the case of transfers to a non-UK domiciled spouse/civil partner). However, if the first death was before March 1975, the full amount may not be transferable as the amount of spouse exemption was limited then under the provisions of Estate Duty.

The transfer is not determined by the balance of the nil rate band unused, but the proportion of the nil rate band that was unused, in accordance with s8A IHTA 1984.

The history of spouse exemption

If the pre-deceased spouse's death (the first death) was before March 1975, the full amount may not be transferable as the amount of spouse exemption was limited then under the provisions of Estate Duty. The history of IHT and the spouse exemption was as follows, and specialist advice should be taken in cases that apply:

- prior to 21 March 1972 – no spouse exemption and therefore likely the nil rate band was used
- 21 March 1972 to 13 March 1975 – Estate Duty applied and there was a transfer of only £15,000. If this was unused, it is likely there would be a balance to transfer
- 13 March 1975 to 18 March 1986 – Capital Transfer Tax applied and the spouse exemption would apply as new rules under Inheritance Tax

Making a claim on form IHT402

If a spouse or civil partner has died previously, they may have some unused nil rate band available that the personal representatives will need to make a formal claim for, when dealing with the estate of the second spouse. This is claimed on form IHT402 that accompanies the inheritance tax return form IHT400.

At the time of the first death, there may not be (or may not have been) a considerable amount of compliance to adhere to, especially if the will or intestacy rules were such that the deceased spouse's estate is transferred to the other spouse, or otherwise simply.

Information that will be required to support the claim for any unused nil rate band will include:

- The death certificate of the first spouse, or civil partner
- The marriage certificate or civil partnership certificate
- The previous will, if relevant
- A copy of the grant of probate (or confirmation in Scotland)
- Any other documentation that would support the amount of nil rate band that is being claimed, such as a deed of variation and a copy of any IHT return forms.

The important point here is that any evidence of the previous spouse's unused nil rate band needs to be recorded thoroughly to avoid problems collating this information at the time of the second death.

Inheritance tax planning on first death

Reasons to utilise the nil rate band on death of the first spouse or civil partner include:

- Bank it, don't lose it – it is possible to improve the loss of any exemption by banking the nil rate band on first death;
- Assets can grow outside an estate – rather than have assets growing in value within the estate of a surviving spouse or civil partner, with the reliance on the transferable nil rate band, consider banking the nil rate band on first death and pass the assets into a trust – any growth on those assets could fall outside everyone's estate for IHT, particularly if the trust is a discretionary trust;
- Building in protection of capital for future beneficiaries – rather than give wealth to a spouse on first death and risk the loss of capital for future beneficiaries, use the nil rate band to ensure the assets are passed to the other beneficiaries or protected within a trust wrapper, for future beneficiaries;
- A maximum of only one transferable nil rate band - note that a spouse or civil partner will only receive the additional benefit of a maximum of one unused nil rate band and therefore if they have been widowed twice, the balance of the unused nil rate bands must be determined, and then capped to the level of one additional nil rate band. A separate claim must be made for each spouse or civil partner that predeceased the individual. Consider utilising and therefore banking the nil rate bands on death to avoid the potential loss of relief;
- To avoid a reservation of benefit – very often, the passing of assets over to a surviving spouse or civil partner generates no IHT due to the luxury of spouse exemption. However, the problem then consists of the whole joint estate being now in the hands of the survivor with the urgency of lifetime IHT planning. Consider the gifting away of assets to other beneficiaries on the first death, using

as many IHT reliefs as possible, to avoid the survivor having to gift assets with the limitation of the seven year survival period and potentially falling into the GWROB provisions.

Using a discretionary trust on death for the interest in the family home

When measuring the amount of the transfer of value, consideration must be made for any part of the asset being owned by a spouse or civil partner. Where spouses or civil partners are the co-owners, it is necessary to consider the related property rules (s161 IHTA 1984).

Example - Related party valuation of land

Jill owned land worth £500,000.

Her husband, Jack, owns the adjacent land that is worth £400,000. However, the combined plots of land are worth £1,300,000.

When Jill died, the personal representatives have the task of valuing her share of land to calculate the amount of IHT payable on her estate.

They will need to consider the related property rules.

The value will be calculated as follows:

$$£1,300,000 \times \frac{£500,000}{£500,000 + £400,000} = £722,222$$

The family home – valuation of property owned by spouses and civil partners

Where spouses or civil partners are the co-owners, it is necessary to consider the related property rules under s161 IHTA 1984 and whether the Capital Taxes Office would value the property resisting any discounts. Where the value of any property comprised in a person's estate would be less than the appropriate portion of the aggregate value of that property and any related property, the value shall be the appropriate portion of that aggregate.

S161 IHTA 1984 suggests that the related property valuation rules would apply to a transfer of value which would realise an enhanced price if sold together with 'related property'.

In the case of *Price v HMRC* (2010) UKFTT 474 (TC) the First Tier Tribunal rejected the claim for discount on the valuation of property even though the property could not be sold with vacant possession.

The family home – the valuation of property – undivided shares

The law relating to undivided shares can be found in the Trusts of Land and Appointment of Trustees Act 1996 (TLATA 1996) and the Law of Property Act 1925.

Whilst the distinction of a joint tenancy and a tenancy in common can be important in determining the extent of a co-owner's interest, once the extent of the interest has been ascertained, the valuation approach will in practice be the same.

Where at the valuation date any co-owner remains in occupation of the property, as their main residence, the normal approach is to take half the freehold vacant possession value and deduct 15%. This approach is in accordance with the Lands Tribunal decision of *Wight and Moss v CIR* (264/932/82).

Where, at the valuation date, a co-owner has a right to occupy the property as their main residence but by choice does not actually occupy, it is necessary to consider the purpose behind the trust for sale or trust of land. If this purpose still exists and is capable of being fulfilled, the discount would normally be 15% and in other cases, 10%.

Example

Mr A owns a half share of the family home (valued at say £300,000) with his wife, Mrs A. They own the property equally as tenants in common as they have each stipulated in their wills that their shares of the property will pass to their son, Malcolm, on their death.

When Mr A died, his share passed to Malcolm and at that point, it seems unlikely that a discount would be available due to the related property rules.

If the son Malcolm was to die before his mother, Mrs A, his share of the property would be valued with a 15% discount as the purpose behind the trust for sale or trust of land still exists (ie, Mrs A is still alive). However, if Mrs A was to die before Malcolm, her half share of the property would be valued with a 10% discount.

Provided the shareowner is deriving some current benefit from the ownership of the share, but where they have no rights of occupation as a main residence, the valuation of this half share would be by taking the full value of the property and making an allowance of 10% from the share fraction. The Lands Tribunal endorsed this principle in the case of *James Anson St Clair-Ford v HMRC* (2006).

Minority shares - In cases where the prospects of a Court granting an order for sale are thought to be less than 'highly likely' or the costs of such an action would be prohibitive, then some greater discount than 10% would be appropriate - and it is suggested this could be up to 20%

Majority shares - A majority shareholder is normally in a more powerful position than a minority one but still has its disadvantages and therefore a discount of up to 10% should be applied in normal circumstances.

Further guidance can be obtained by visiting the Valuation Office Agency website at - http://www.voa.gov.uk/corporate/Publications/Manuals/InheritanceTaxManual/sections/r-section_18/b-iht-man-s18.html

The family home - the case of Woodhall v CIR - was there an IIP?

In the case of *Woodhall v CIR* a father died leaving his home to his two children for their lifetime. One of the children occupied the house and died in occupation.

The case established that there was an interest in possession of just 50% and not 100% even though the other child did not occupy the property. The purpose and effect was to give each child a determinable life interest.

The family home – the case of Faulkner - was there an IIP?

In the case of Faulkner (Adams Trustee) 2001, Mr Adams died leaving a will and a letter of wishes stating that Mr and Mrs Harrison could live in the property during their lifetimes. It was held that the will established an interest in possession and not, as the taxpayers claimed, a licence to occupy.

Contributed by Amanda Fisher