

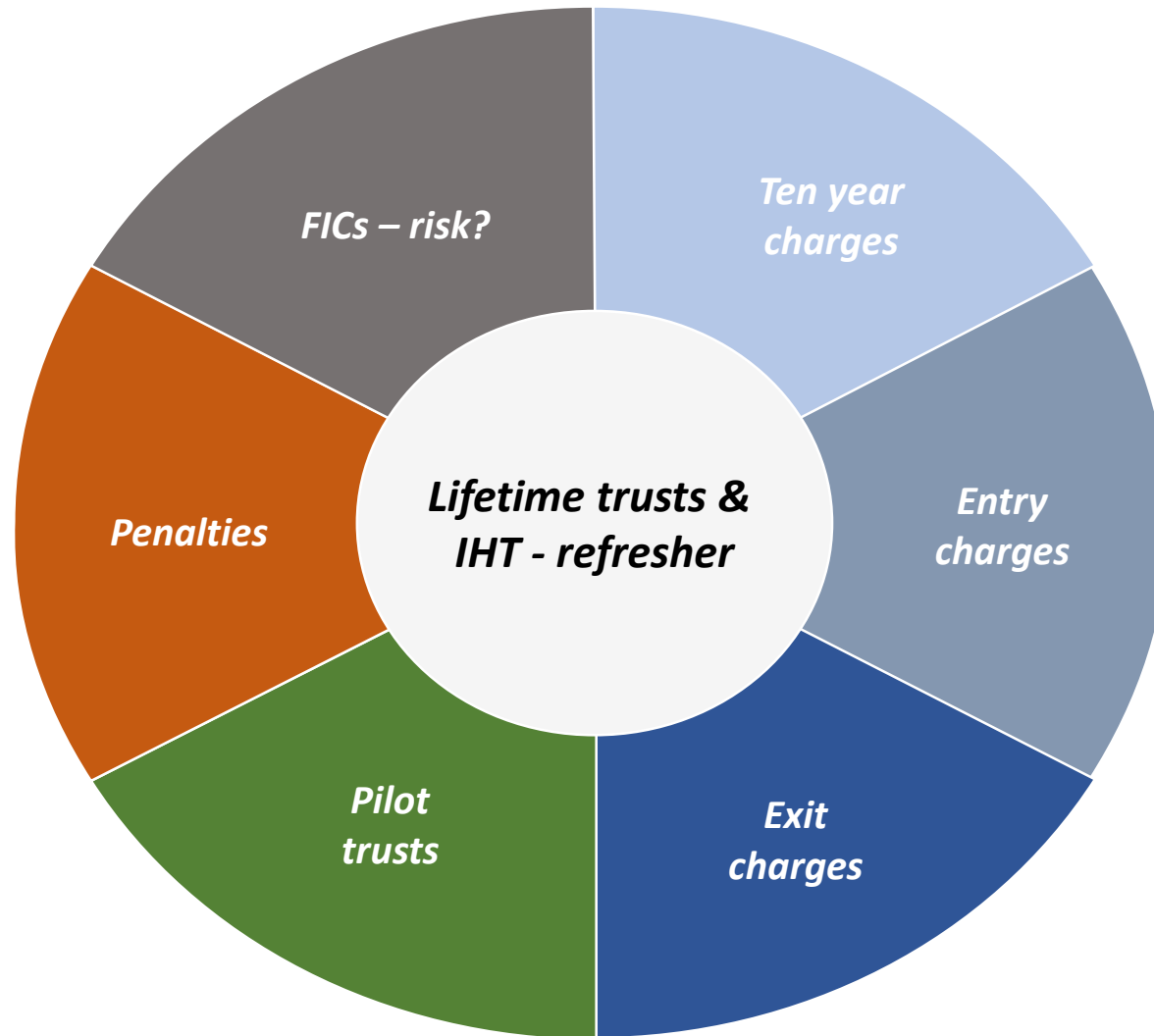
STEP Liverpool branch

Lifetime trusts & IHT - refresher

April 2017

Lee Blackshaw CTA, TEP, ATT (Fellow)





Explaining ten year charges to clients



“Swaps 40% on unknown date for up to 6% every 10 years”

“the rate often is less than 6%”

“Where media says ‘Estate of X avoids £m of IHT’... probably means trust paying 6%”

“An annualised ‘entry fee’ or ‘wealth tax’ of up to 0.6%pa”

“If a 0% IHT rate, that rate usually applies for the next 10 years”

“No charge on the death of a beneficiary”

“On some assets, can be paid in instalments”

“Useful for high growth assets”

“The 6% rate attempts to collect similar IT over a generation but usually collects much less”



Ten year charge - basics

The easy calculation (if simple facts)

- Eg 6% x (£500,000 value - £325,000 nil rate band) = £10,500 tax
- A rate of 2.1%

Complications (rare?)

- Cumulative total not being nil
- Related settlements
- Added property
- Other transfers out before this one
- Capitalised or undistributed income – the most common complication

Tips

- Don't add property to existing trusts...
- ...except perhaps exempt transfers, such as annual £3k, normal expenditure, life assurance premiums?
- Plan to have BPR (AIM shares?!) two years up to an anniversary?
- Carefully note any complications and the impact in advance of a ten year charge
- Review income and decide to capitalise, distribute or do nothing



Ten year charge – recent changes

Recent changes

- 2012, 2013 & 2014 consultations on simplification
- Most of the proposals (eg settlement nil rate band) dropped
- Main changes: undistributed income, reporting & payment dates, pilot trusts, post 18/11/2015 ignore historic non-relevant property
- Restrictions on debts

Capitalised income

- Subject to IHT
- Time apportioned, as not been relevant property for ten years

Income undistributed for five years

- subject to IHT (from s117, FA 2014 change)
- ten year charge only, not on exit charge
- Not time apportioned
- Therefore better to capitalise, distribute or even create *revocable* IIPs?



Ten year charge – more complex

Settlor transfers < 7 years of trust and some capitalised income

- Settlor's cumulative total £100,000
- £500,000 value including £50,000 income capitalised 1 year ago
- $(£450,000 - (£325,000 - £100,000)) \times 6\% + \underline{£50,000 \times 6\% \times 4/40}$
- Which is £13,500 + £300 = £13,800
- An effective rate of 2.76%

Reduced charge on capitalised income



Ten year charge – former A&M now relevant property

Eg anniversary date 1 March 2017

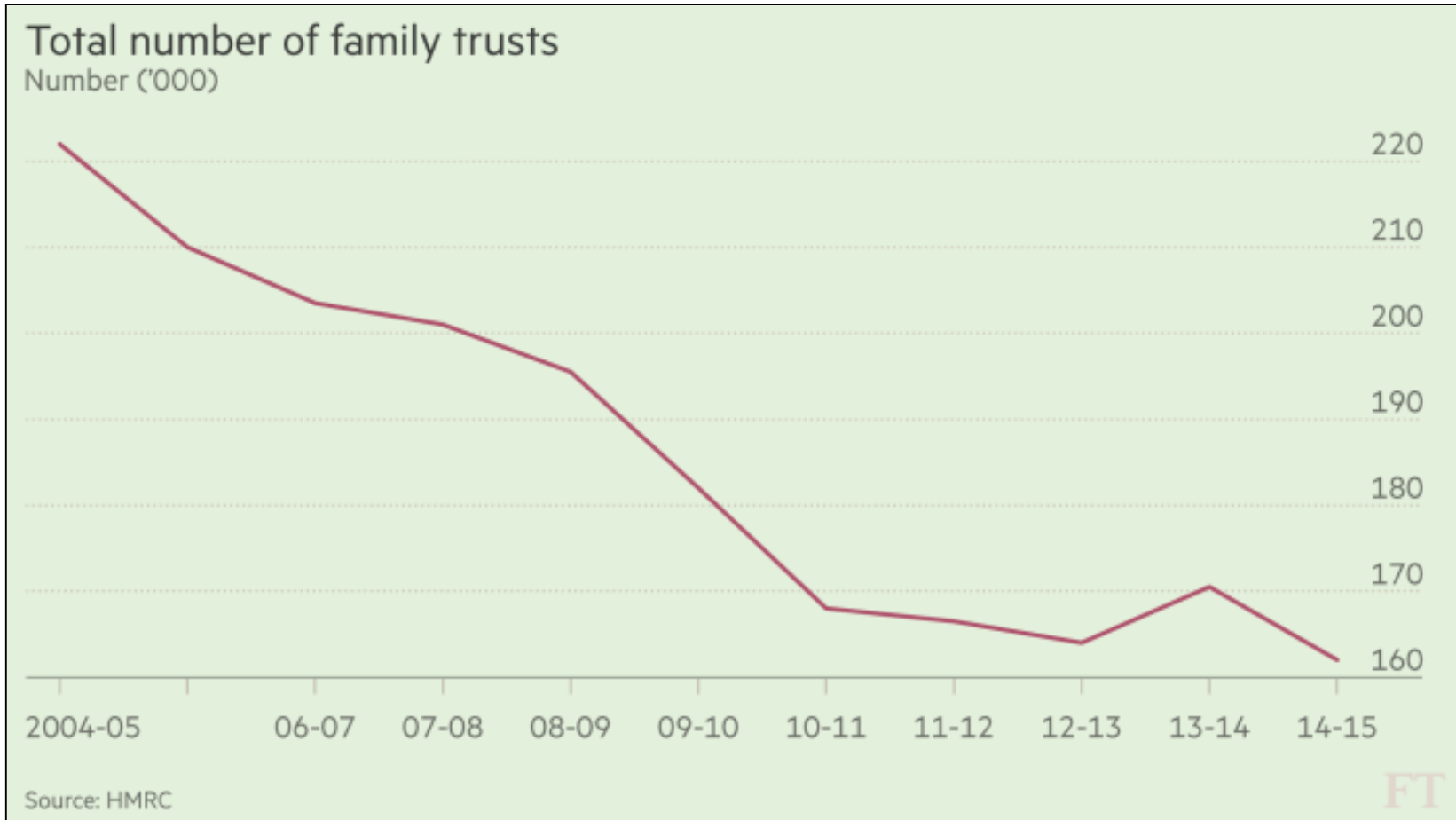
- Previous anniversary date 1 March 2007 – before the 2006 changes to IHT became effective, so no 10 year charge then as not relevant property
- Relevant property since 6 April 2008
- £500,000 value on 1 March 2017
- $(£500,000 - £325,000) \times 6\% \times 35/40$
- Which is £9,187.50
- An effective rate of 1.838%

Reduced charge as not relevant property throughout

Notes

- But are we sure the settlor's cumulative total was £nil?
- Anniversary is the commencement date of the trust

Number of trusts – FT 3 February 2017





Entry charge

Current state of play for new trusts (post 2006 changes)

- Gifts to trust < £325,000 (and again every 7 years and bit?)
- Administration costs?
- Create revocable IIPs to ease tax position (neutral for IHT) – a reason for the HMRC/FT statistics as fewer tax returns?

BPR assets eg private company shares that might be sold

- One remaining use is BPR shares
- (if it doesn't impact on entrepreneurs' relief)
- Eg possible sale £14m, mostly gain
- Transfer £3m or so of shares into trust with BPR and s260 TCGA 1992 holdover?
- Watch out for binding contract for sale s113, IHTA 1984
- Get IHT valuation right – open market, hypothetical willing vendor and purchaser, RICS valuer, loss to donor principle



Exit charge

s65 IHTA 1984

- Not just capital appointments
- Also disposition causes fall in value of relevant property (creation of pre-2006 IIPs)

Exit charge within first ten years

- Value on commencement (but BPR/APR not given for this purpose)
- No revaluation required (useful for high growth asset)
- Quarters used
- If (settlor's cumulative total + commencement value) < current nil rate band = 0% rate

Notes

- Beware the BPR (and APR) trap as initial value calculated without BPR (ok if appointed property itself qualifies eg after two years for BPR?)
- Is it better to appoint now or three months after the first ten year charge?
- What future changes to IHT/BPR might take place?



Exit charge

Between ten year anniversaries

- Last ten year rate x number of quarters
- Eg $2.1\% \times 13/40 = 0.683\%$
- Could be 0%, if BPR on previous anniversary

The easy calculation (if simple facts)

- Eg a rate of 2.1% (from previous ten year charge example)
- Capital of £500,000 has grown to £1m and £400,000 appointed out 3 years and 4 months after that ten year charge
- IHT is $£400,000 \times 2.1\% \times 13/40 = £2,730$
- Rounding to 3 decimal places usually accepted
- Recalculate if nil rate band increased since last ten year charge

Other

- Adjust computations if additions etc – see 69(1), (2), (3)
- Beware the s260 CGT holdover *Frankland* s65(4) IHT trap - appointments within 3 months
- (trap removed for s144 will trusts from 10/12/2014)



Other points

GROBs

- Settlor interested trusts still within ten year charge regime

Post 6 April 2008 “newly” relevant property trusts

- What if distribution before that 10 year charge?
- IHTA 1984 s69(2) & (3) fix a notional rate

Some trust exemptions from IHT

- Pre 2006 “A day” FURBS
- Employee trusts

Generally

- Keep a log of ten year anniversary dates
- Prepare annual accounts (even if one page) and note IHT aspects
- Have annual trustees’ meeting and note IHT aspects
- Some IHT can be paid in ten annual instalments



Returns and payment dates

Returns & tax payment

- Due 6 months from end of month of event
- (except for lifetime transfers into trust – pre 2014 regime still applies)
- No order of priority of payee in s199 to s205 IHTA 1984
- Gross up if *transferor* pays the IHT
- IHT30 certificate



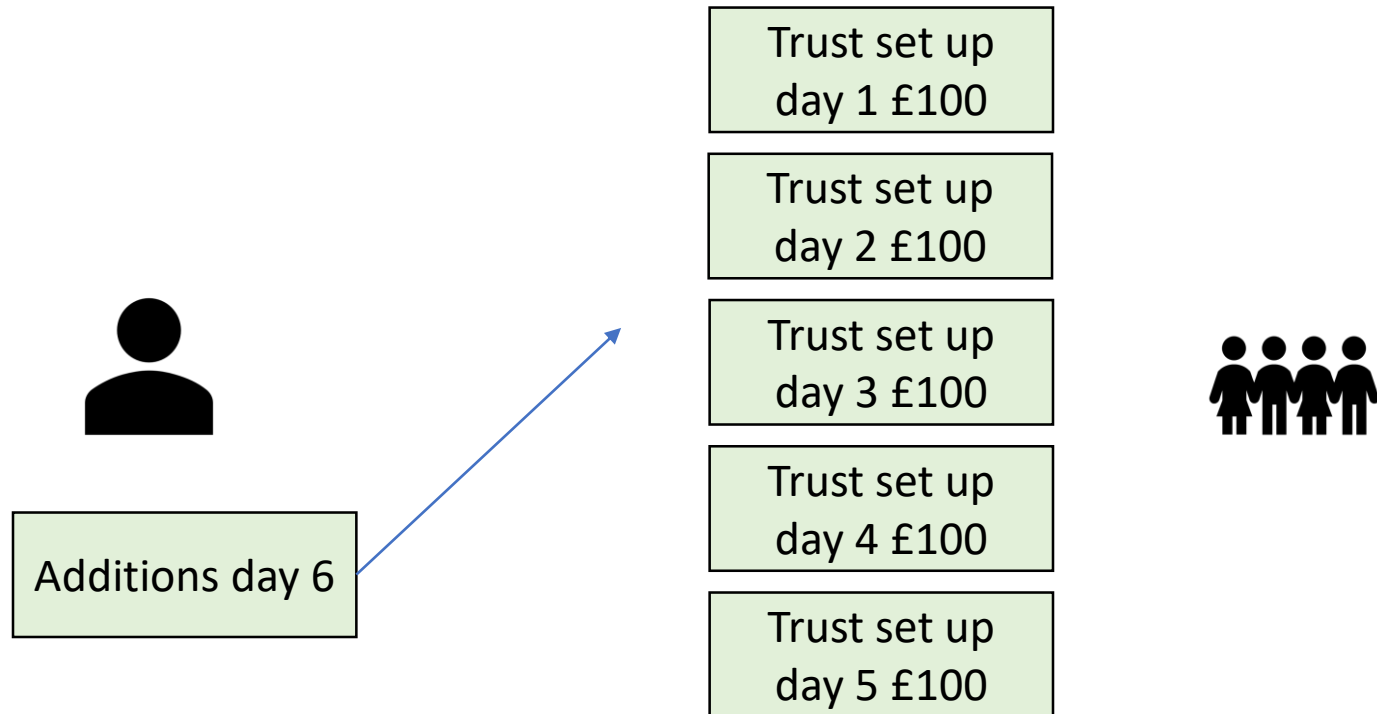
Excluded property trusts

- Watch out for residential property IHT exposure – new SchA1, IHTA 1984
- And UK situs assets generally (eg loans)
- Fear of s65 IHT charge on residential property being sold and so ceasing to be relevant property? - no, Finance (No2) Bill 2017 adds sub s65(7B) to relieve this
- Be careful with deductions for debts linked to residential property
- Ten year charges
- Settlor's domicile
- “Born in the UK” non doms who return
- Also ATED / Non resident CGT / ATED CGT (including nil returns / penalties)
- Further problems if settlor interested excluded property trust?



Pilot trusts – the past

- *Rysaffe* type planning
- Avoided related settlements
- Capture 5 (or more!) nil rate bands
- Stopped 10 December 2014
- Some grandfathering for existing trusts and additions by death before 5 April 2017





Pilot trusts – now

- Still ok for low value high potential growth assets?
- Separate days but no same day additions
- Possibly add on separate days (or within £5,000 de minimis?)
- Take care where clients waive loans or other events in relation to more than one trust on the same day
- DOTAS, GAAR, PCRT?



Trust set up
day 1 **asset**

Trust set up
day 2 **asset**

Trust set up
day 3 **asset**

Trust set up
day 4 **asset**

Trust set up
day 5 **asset**





Penalties

Missed 10 year charge?

- an old forgotten trust, A&M now relevant property, new client?

Consequences

- £3,000 penalty? Capped to tax due, under s245(5)
- Reasonable excuse?
- Reliance on adviser error (unlike VAT legislation, which excludes such defence)?
- *NA Dudley Electrical Contractors Ltd TC1124* (doesn't need to be exceptional)
- *Stephen Taylor v Revenue & Customs Commissioners [2015] UKFTT TC04375* (functional error can be reasonable)
- *Mr & Mrs Carrasco v HMRC [2016] TC05460* (although “care” rather than “excuse”, useful for meaning of reasonable)
- HMRC send penalty before acting on the IHT return

Future

- SI will bring penalties in line with FA 2009, sch55 regime – but when?
- Then look to suspend penalties for careless behaviour (HMRC wrongly argue you cannot suspend non-repeatable offences or forget to consider suspension)



FICs as alternatives to trusts – risks?

- Family Investment Companies can be very useful (where BPR/APR is not available)
- PET, replicates some flexibility of trusts, income tax benefits
- Issues:
 - Complexity
 - future company tax rates change
 - company law changes
 - possible targeted legislation (see-through legislation taxing the income?)
 - costs, administration & reporting requirements
 - difficult to unravel
 - publicity, unless an unlimited company is used
 - will media press see them (rightly or wrongly) as a next tax dodge?
 - double tax charge on assets that grow in value and are extracted
 - family/shareholder disputes
 - unknown unknowns
- Can a simple gift, life cover and pre-nup be better for “sensible” children?

Summary of tips – page 1



Annual accounts
(even if one page)

Annual trustee
meeting

Keep log of next IHT
event

Note on client file of
any complications (eg
added property)

Don't add property to
existing trusts

Review income to
distribute, capitalise or
do nothing

Consider revocable IIPs
to ease tax &
administration

Draft IHT
computations early
and don't undervalue
the work

Does the instalment
option help?



IHT30 certificate

Appeal penalties

Take care on BPR trap
within first 10 years

Beware CGT holdover
trap in first quarter

Consider FICs as trust
alternatives (but
consider risks)

Explain trust IHT to
clients

Pilot trusts still useful?

IHT on residential
property in otherwise
excluded property
trust

Consider DOTAS,
GAAR, PCRT

Questions?



Slides available by emailed pdf and please email any questions/suggestions.

(Thanks to Wayne Dutton of PwC for help in planning the content of these slides.)

lee@blackshawtax.com
07720 298442



Family business owners, trustees,
beneficiaries, entrepreneurs,
'non-doms', inherited wealth

Blackshaw Tax Ltd is a company registered in England & Wales with company number 10051657 and registered office 43 Mayors Road, Altrincham Cheshire WA15 9RW. VAT registration number GB 236 3857 87. Blackshaw Tax Ltd does not accept liability for reliance on this presentation by attendees or other parties. Full advice should be taken subject to an agreed engagement letter and terms of business.