Trust Referencer

Focused Report

for

A life interest
arising in a Will

Report includes the following sections

Outline
Inheritance Tax
Capital Gains Tax
Income Tax

This Trust Referencer Report was created on 4th June, 2018.

Please note that:

Trust Referencer is constantly updated
It assumes the relevant parties are domiciled and resident within the U.K.
References to the masculine gender include the feminine
The agreed Terms and Conditions apply to the reliance upon its content.

Outline

In respect of this testamentary trust creating an immediate life interest for the spouse/civil partner (with a continuing trust), this flexible life trust for the spouse/partner will have the advantage of being treated from the outset as an Immediate Post Death Interest (IPDI).

Generally

- The trust is created with a view to flexibility.
- It can protect the capital of the trust against future bankruptcy of the surviving spouse, against local authority nursing home fees, and claims by any future spouse or partner of the survivor.
- It is usual for the trustees to have power to pay capital to the life tenant This is desirable in case of emergencies or changed circumstances.
- It is possible for the trustees to be given power to terminate the life interest, in whole or in part. This can be used as an aid to IHT planning with a focus on utilising the annual IHT and normal expenditure out of income exemptions, of the surviving spouse. If the consent of the surviving spouse is not required the trustees can still act if he or she loses capacity.
- It is usual for a discretionary trust to continue on the termination of the life interest.

Inheritance Tax

In respect of this testamentary trust creating an immediate flexible life interest for spouse/civil partner (with a continuing trust) and which came into being post 22 March 2006 :

- This is an Immediate Post Death Interest (IPDI) as set out in s.49A Inheritance Tax Act 1984.
- As the life tenant is the spouse/civil partner the usual spouse exemption under s18 IHTA 1984 will be available and any IHT is calculated in the normal way on the testator's estate.
- The commencement value of the trust fund will be determined by reference to the administration of the testator's estate.
- During the trust there are no 10 year periodic or exit charges.
- Upon the termination or appointment out of this IPIDI trust the trustees should be mindful as to the provisions to qualify for any additional residence nil rate band relief.
- If the trustees terminate the life interest, the IPDI ends and the continuing trust will be treated as a relevant property trust.
- Surrender of the life interest by the life tenant will also end the IPDI trust and the continuing trust will be treated as being subject to the relevant property regime.
- Either upon such termination or surrender, during the lifetime of the life tenant, will require the fund to be re-valued, as this creates an immediate charge to IHT at half the IHT rates applicable at death.

- This would be 0%, if within the life tenant's available nil rate band but otherwise the rate will be 20%. It is not possible to treat this as a PET as the fund continues to be held in trust.
- Any early termination or surrender will be treated as a lifetime transfer of the life tenant which could result in additional IHT being payable if he dies within 7 years, subject to taper relief if the death is more than 3 years after such IHT event.
- If no early termination or surrender upon the death of the life tenant the trust fund is re-valued.
- The trust fund is aggregated with the life tenant's free estate.
- The trust fund will suffer its rateable proportion of any IHT payable on the basis the fund, and personal assets, are all subject to IHT on the death of the life tenant.
- The settlement will now be treated as a relevant property trust with the same value of the fund at the date of death of the life tenant.
- The trust fund is re-valued at 10 yearly intervals. With effect from 6 April 2014 this includes undistributed and unaccumulated income which has been held by the trust for more than five years prior to the valuation date.
- At each 10 year anniversary, a charge can arise, currently at a maximum rate of 6%.
- The anniversary charge may be nil, or reduced, if the trust comprised property of, no more than, the available nil rate exemption of the life tenant.
- Upon any capital distribution, or at the end of the trust, the trust fund is re-valued and at which point, an exit charge may be payable.
- The rate of the exit charge will be a proportion of the anniversary charge calculated, by reference to the number of complete 3 month periods, either from the last 10 year anniversary or from the commencement of the relevant property trust, if no anniversary.
- The exit charge may be nil, or reduced, if the trust has available, all or part of, the nil rate exemption of the life tenant.
- Both anniversary and exit charges may be avoided or reduced if the trust fund comprises property which has its own IHT reliefs. e.g. APR, BPR.
- If exit charges apply during the first ten years of a discretionary trust's life then business and agricultural property relief may not always be available to reduce the exit charge.
- For chargeable transfers made on or after 6 April 2014 both the filing date and payment dates are six months from the end of the month in which the tax event occurred.

Capital Gains Tax

In respect of this testamentary trust creating an immediate life interest for spouse/civil partner, where there is a continuing trust. The principal main residence is an asset of the trust:

- The death of the testator does not create a charge for CGT.

- In respect of any disposals by the personal representatives (as opposed to the trustees) in the tax year when the testator died and/or in the following 2 tax years, they will be entitled to claim the individual's annual exemption (2018/19 being £11,700).

- The trustees are deemed to acquire the assets of the trust at the probate value.

- No CGT charge will arise upon the disposal of certain exempt trust assets, a person's only or principal main residence being the most important. Additionally these include gilt-edged securities, shares in Venture Capital Trusts/Enterprise Investment schemes and moveable chattels sold for less than £6,000.

- If during the trust, the trustees sell any asset being part of the trust fund, this may cause CGT to be payable in respect of the difference between the sale price above the acquisition or deemed acquisition cost, deducting the costs of sale, any available exemptions and allowable losses. If the disposal, includes business assets, relief and entrepreneurs' relief may be available to the trustees.

- The death or surrender of the life interest by the spouse/civil partner or termination by the trustees will not be deemed to be a disposal for CGT purposes.

- When the trust ends or when a beneficiary becomes absolutely entitled to assets forming all or part of trust property this will be deemed to be a disposal by the trustees and subject to CGT. This will be payable in respect of the difference between the market value of trust assets above their acquisition or deemed acquisition cost allowing for any available exemptions and losses.

- As this would be treated as an immediate chargeable IHT event relief may be available.

- Any capital gain arising in the period(s) during the trust when the spouse or civil partner, or any subsequent beneficiary occupied all or part of trust property, with the consent of the trustees as his principal main residence, will be exempt from CGT.

    - The exemption includes garden and grounds of up to 0.5 hectare and is available even though occupation, under the terms of the trust, was at the discretion of the trustees. If the garden and house are sold separately then for exemption to apply to the garden and grounds the garden and grounds must be sold before the main house.

    - Where the grounds exceed 0.5 hectare then the extra may qualify for relief if the land above 0.5 hectare is required for the reasonable enjoyment of the property on an objective test.

- Upon a disposal trustees pay CGT at 20% (whereas private individuals may pay at rates between 10% and 20%). If the disposal is of a residential property not qualifying for private residence relief trustees pay CGT at 28% (whereas private individuals may pay at rates between 18% and 28%). Therefore the executors should consider any opportunity to transfer the asset directly to the beneficiary, for him, to dispose of, if a lower rate of tax applies or a larger annual exemption applies.

- In respect of disposals by the trustees they have an annual exemption of half that of an individual (2018/19 being £5,850). The exemption would reduce if the settlor had created other settlements which should be pro-rated between the number of settlements created by the settlor but with a minimum of £1,170 for 2018/19.

Income Tax

In respect of this testamentary trust creating an immediate life interest for spouse/civil partner, where there is a continuing trust, the main residence is an asset of the trust:

- Until the completion of the administration of the estate, the personal representatives pay income tax determined by the type of income received but without personal allowances. They do not pay higher rate tax.

- The trustees become responsible when the trust funds are transferred to them, by the personal representatives.

- At its commencement this is an interest in possession trust, for income tax purposes, as the spouse/partner tenant has a right to receive trust income, after the payment of allowable expenses.

- whilst the trust is non-discretionary the trustees pay tax at the following rates, which for the 2018/19 tax year are:

    - 20% (the 'basic rate') on all income (rent business income and savings) unless of a capital nature deemed to be income (see below).

    - 7.5% Dividend Type income.

    - The trustees are not able to claim the Dividend Allowance of £2,000 per annum nor the Personal Savings Allowance of £1000 per annum in respect of savings interest etc but both of those allowances will be available to the beneficiary when the income is received by them.

- Upon the death of the spouse, early termination or surrender of the life interest, the trust fund, according to the terms of the trust, could change to being treated as a discretionary or an accumulations trust, when income is taxed at the following rates, which for the 2018/19 tax year are as set below.

- Trust income up to £1,000 (if there is more than one trust this standard rate £1,000 band is shared between the like trusts - subject to a minimum of £200):

    - 20% (basic rate) when the income is rent, trading and savings

    - 7.5% (dividend ordinary rate) for UK dividends such as income from stocks and shares (if the basic rate is not fully utilized).

- Trust income over £1,000:

    - 38.1% (dividend trust rate) when the income is dividends and distributions

    - 45% (trust rate) for other income.

- Various sums that are capital in trust law are deemed to be income for tax purposes and the above dividend trust (38.1%) and trust rate (45%) apply. These are:

    - company purchase of its own shares (dividend rate applies)

- gains arising on contracts for life insurance
- profits on the disposal of deeply discounted securities
- disposals of futures and options
- sales of foreign dividend coupons
- chargeable events in respect of employee share ownership trusts
- offshore income gains
- lease premiums
- transactions in deposit rights
- transactions in land arising under the anti-avoidance provisions
- accrued Income Scheme charges

- The free use or occupation of trust property by the spouse does not create an income tax liability.
- If the trustees are carrying on a trade they would be able to deduct allowable business expenses. ITTOIA 2005.
- Any trust expenses, attributable to income, are first set off against dividend-type income. Capital expenses are not deductible against income.
- While the trust is non-discretionary, the trustees pay the net income to or on behalf of the beneficiary and give a certificate of tax deducted (form R185).
- If the beneficiary is not a taxpayer he might be able to claim some or all of the tax back other than on dividend type income. If the beneficiary pays tax at a rate above 20% then he will have to pay additional tax over to HMRC through his self-assessment return.
- Upon the trust becoming discretionary, to ensure that the trustees have paid sufficient income tax, the trustees are required by HMRC to keep a record of tax payments, known as the 'tax pool'. This will assist the trustees to make net distributions to beneficiaries over the tax year. Any tax shortfall has to be paid over to HMRC through the trust's tax return.
- The trustees pay the net income to the beneficiary with form R185, showing a tax credit of 45%.
- If the beneficiary is not a taxpayer or pays tax at a rate below 45% he might be able to claim some or all of the tax back, other than on dividend-type income.