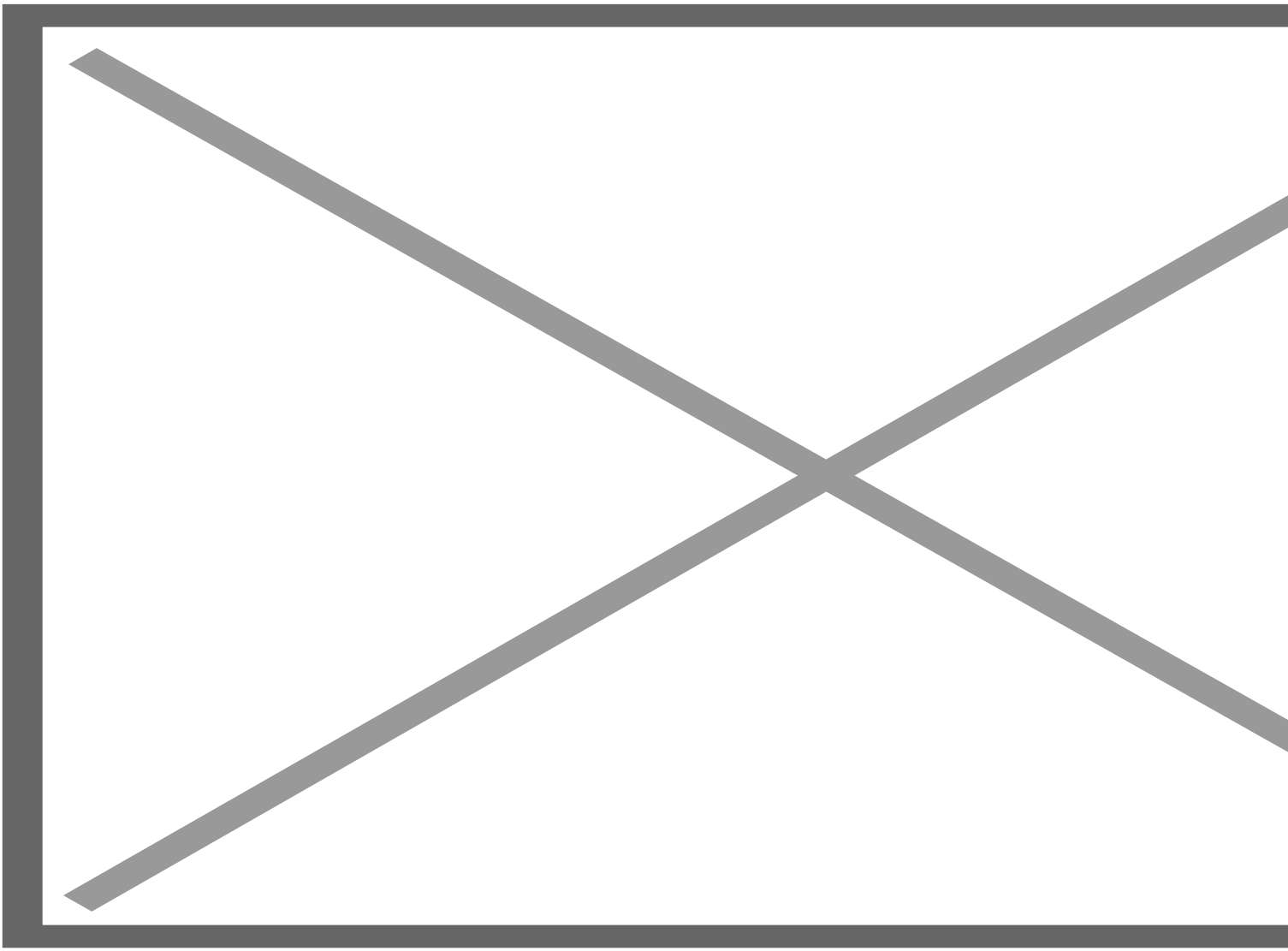
Home Sweet Home

Inheritance tax and trusts



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Sue Knight and *Natalie Iceton* provide guidance on the importance of considering the family home when estate planning

Key Points

What is the issue?

The family home is a valuable asset and one that is often overlooked in estate planning.

What does it mean to me?

When advising families the family home should be considered as overlooking it may lead to unexpected IHT liabilities.

What can I take away?

An overview of the planning available for the family home.

For many the family home will be a valuable, if not the most valuable, asset that they own. However, often the family home is the last asset to be considered when it comes to inheritance tax (IHT) planning.

The reason is partly the pre-owned assets tax anti-avoidance legislation that was effective from 6 April 2005 largely in order to combat the proliferation of IHT planning based on the *Ingram* and *Eversden* cases, and the home loan scheme double trust planning. There are also the gifts with reservation of benefit (GROB) rules as well as capital gains tax (CGT), income tax and stamp duty land tax (SDLT) implications.

Another important factor is that the family home is often an asset to which the occupants have formed a close emotional attachment. Any planning needs to be practical and sensible.

Double trust schemes

Readers with clients that implemented IHT planning, e.g. the home loan double trust planning, may be considering their options. One option is to wait for a case to go to Tribunal. Even if this does happen it may not resolve all the technical issues as different variants of the planning were implemented. If the clients are still alive there is an opportunity, circumstances depending, to unwind. Any unwind will need to be considered carefully including IHT, CGT and SDLT implications, as there is no one size fits all solution.

For taxpayers with no current planning in place, there remain a number of options to mitigate IHT on their home, which we consider below.

Simple makes sense

It is often easy to overlook the benefits derived from basic planning points. An example of this is the residence nil rate band (RNRB) which is being introduced from 6 April 2017 found in IHTA 1984 s 8D et seq. This additional nil rate band is available to set against the value of residential property on death when it is passed to lineal descendants (children, grandchildren etc.) and means that for an individual their total nil rate band could be £425,000 in 2017/18 increasing to £500,000 in 2020/21. Any unused RNRB not used on the first death is carried forward to be added to the spouse's residential nil rate band on their death. There is a tapering of the relief for estates valued at over £2 million. However one can imagine how beneficial this additional relief will be for couples with moderately valued properties. It is not available to set against lifetime gifts. Therefore if an individual gifts their home away in their lifetime but dies within seven years the benefit of the RNRB will be lost. For those who sell or downsize their homes after 8 July 2015 the RNRB will still be available where the higher value is still included in their estate and is inherited by a lineal descendant.

Gifting but continuing to use the property

Sometimes the donors want to continue to live in the property after it has been gifted away which would be caught by the GROB rules in FA 1986 s 102. The options include:

Gift and leaseback

This approach is relatively low risk, being referred to in the HMRC manuals (for example IHTM14360) and will be suitable where the donors are in the age range 65-70 and have sufficient cash or investments to live off and to fund rental payments in the future. It may also be suitable where the donors would like the security of having a legal arrangement in place for their continued occupation of the property.

The current owners would gift their house e.g. to their adult children or grandchildren. The gift is a PET and so as long as the donors survive the gift by seven years the value of the house (including increase in value) is removed from their estate.

If the donors want to continue to live in the property they would need to pay a full market rent as this prevents the GROB and pre-owned assets tax rules applying. This is an important point and it is essential that the value of a full market rent is considered. Ideally separate property agents would be appointed by the lessor and the lessee to negotiate an appropriate market rent based on the specific terms of the lease envisaged. The lease would ideally be long enough to exceed the donors' lifetimes or contain an option for the lessee to renew on similar terms, and SDLT needs to be considered on the grant of the lease.

The rent paid will reduce the donors' estates further but will increase the estate of the donee and will be chargeable to income tax in their hands.
The CGT position also needs to be considered including whether main residence relief is available on the gift, and the loss of the tax free uplift on death.

Gift of undivided share and joint occupation

The gift of a share in a property and then sharing occupation may be appropriate where the donor and donee have always lived in the property, e.g. where a child moves in with a parent to care for them. It will not be suitable in all circumstances and the donors may be vulnerable to changes in family circumstances such as divorce or fallings out.

The gift of the property will be a PET by the parents which they will need to survive by seven years for it to fall outside their estate. The gift potentially falls within the GROB legislation (FA 1986 s 102A), however s 102B(4) provides a let out where 'the donor and donee occupy the land and the donor does not receive any benefit, other than a negligible one, which is provided by or at the expense of the donee for some reason connected with the gift'. To fall within this the donor must pay at least his share of the costs of living in the property. It is this let out from the GROB legislation that also excludes the arrangement from pre-owned assets tax under FA 2004 Sch 15 para 11(5)(c).

Two important points to consider are:

1. What does occupation mean? It is considered that one does not need to live in the house all the time to be occupying it. But there does need to be substance and evidence to support that use is more than as a guest.
2. What proportion of the property should be gifted? Only an undivided share is required. However one should assume that HMRC will not like the share to be disproportionate to the number of people living in the property.

If appropriate, this often practical solution would result in the gifted share being outside the donor's estate as well as any increase in value of the share of property given away.

Reversionary lease

Where one spouse has already died it is common for a life interest will trust to own the property with the surviving spouse living in the property in their capacity as life tenant of the trust. Here it may be suitable to consider the trustees granting a reversionary lease to the next generation to remove the majority of the value of the property from the life tenant's estate.

The trustees would grant a long lease (say for 100 years or more) to the children or grandchildren, under which no rent is payable and there are no covenants imposed. This lease would not however, take effect until 15 years from now. The freehold interest in the property would remain with the trustees.

The grant of the lease is a PET by the surviving spouse but the spouse is then entitled to live in the property free of rent for the next 15 years since the freehold remains property of the trust.

As long as there has been an adequate 'carve out' of the interests then there should not be a GROB under FA 1986 s 102. The life tenant is not deemed to have made the gift for the purposes of FA 1986 s 102A, therefore this should not give rise to a GROB either. In any case s 102A(5) provides additional protection where the spouse has had the IIP in the house for more than seven years.

There is an argument that pre owned assets tax should not apply on the basis that the life tenant has not actually disposed of an interest in land, or alternatively that it will be charged at a very low level since the value of what the life tenant has given away is minimal (being the right to receive rent for the period between the start of the reversionary lease and their death).

On this basis, the grant of a reversionary lease can be a very effective tool in the right circumstances, albeit more complex than the other ideas suggested, and mitigation of CGT on future sale also needs to be considered.

A final word

Estate planning for the family home should not be overlooked. However, as with other tax planning, the suitability of the planning will be driven by the actual fact pattern.