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Wills and tax planning

This paper by Charles Holbech provides a detailed guide in relation to wills and tax planning with examples and some precedents. Guidance is given in respect of nil rate band trusts, business and agricultural property, will trusts, charitable gifts, the residential nil rate band and deeds of variation.

It is designed to serve as a useful quick reference for practitioners. Its various sections can be navigated via the hyperlinked table of contents overleaf.

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Call: 1998

Barrister

Charles Holbech specialises in private client work, both contentious and non-contentious, often involving technical advice on tax, trusts and estates. He is recognised by Chambers UK Bar, Chambers HNW and The Legal 500 UK Bar as a leading junior for Chancery and private client work. He has edited Halsbury's Laws of England on Inheritance Tax and contributed the chapter on Taxation in Williams, Mortimer & Sunnucks, Executors, Administrators and Probate.

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NIL RATE BAND TRUSTS

Standard Will

It has long been standard IHT planning for a married testator or civil partner ("T") to leave:

(a) a legacy up to the maximum nil rate band ("NRB") to a discretionary trust for a class of beneficiaries including the surviving spouse or civil partner ("S"), children and remoter issue; and
(b) the residue to S absolutely, or on IPDI trusts.

In this way, T's NRB is fully utilised on T's death, no IHT being payable as the chargeable transfer is taxed at 0%.

Before the introduction of the transferable nil rate band ("TNRB") it was not good tax planning for T to leave everything to S, and for S to leave their combined property to the children. On S's death, S and T's combined estate would be subject to IHT, but only one (S's) NRB would apply. T's NRB would have been wasted.

Tax benefits of NRB trust

Tax benefits of a NRB discretionary are:

(a) There will be no IHT liability on T's death in respect of the NRB legacy (since it is within the NRB) or in respect of the residuary gift to S (since it is exempt).
(b) The property in the NRB trust will not form part of S's taxable estate on S's death and will, therefore, avoid IHT at 40% above S's NRB.
(c) Distributions within the first 10 years of death will be at a nil rate for IHT purposes, and there will only be a 10-year charge if and to the extent that the value of the trust fund, including any distributions in the 10 years since death, exceeds the NRB.
(d) The NRB legacy to the NRB trustees will decrease the value of S's estate. This may be useful given that the residential nil rate band ("RNRB") tapers by £1 for every £2 above £2m.

In addition, S may benefit from the trust during their lifetime, if in need. Income could, for instance, be paid to S.

Transferable nil rate band

The advantages of a NRB trust were somewhat diminished by the introduction of the transferable nil rate band ("TNRB").

Where a widow or widower dies on or after 9 October 2007 their personal representatives may make a claim for an additional NRB (the TNRB) if their spouse died previously without utilising the whole of their NRB. The amount of the NRB available for transfer to the estate of the surviving spouse is based on the proportion of the NRB that was unused on the first death (IHTA 1984, ss. 8A-8C). A claim must be made on the death of the surviving spouse for the TNRB to apply.

If, therefore, T died leaving the whole of their estate to S absolutely, or to S on IPDI trusts, no IHT will be paid on T's death (due to the spouse exemption). 100% of T's nil rate band will have been unused on their death. On S's death, S's personal representatives may claim a 100% uplift in the NRB.

S can have their cake and eat it. S can have the whole of T's estate (absolutely or for life) but their own estate will be entitled to a double NRB on their death. The GGT-free uplift on death will also apply.

There is, therefore, arguably no need for a NRB trust.

Reasons not to use a NRB trust

There are some good reasons for steering clear of a NRB trust:

(a) There are income tax disadvantages in a discretionary trust. In particular, the channelling of dividends through such a trust leads to a disproportionately high rate of tax.
(b) The costs of administering a small discretionary trust may be a disincentive.
(c) There are money laundering and other regulatory requirements applicable to a trust.

Reasons for using a NRB trust

Nonetheless, there are attractions in using a NRB trust in the case of a married testator or civil partner (T):

(a) If T has children by their first marriage, they may not want to leave the whole of their estate to the surviving spouse or civil partner (S) absolutely, or even on IPDI trusts.
(b) T may want to ensure that part of their estate (equal to the NRB) is held on discretionary trusts for S and their children protected from claims by creditors, ex-spouses, or liability for care home fees.
(c) S may have independent resources so that they do not need a gift of the whole of T's estate.

Value of NRB trust assets greater than TNRB

Given that the NRB is frozen at £325,000 up to and including 2025-26, it may still be advisable to settle £325,000 on a NRB trust in the hope that the value of the trust fund on S's death will have more than doubled.

T dies in 2021 leaving their whole estate to their spouse, S.
The NRB on T's death is £325,000.
S dies in 2025. The NRB is then £325,000.

S's estate will, in 2025 be entitled to a double NRB (£650,000) if S's PRs make a claim to T's TNRB.

A NRB legacy to a NRB trust might save more IHT:

T leaves a NRB legacy (£325,000) to NRB trust.
On S's death the trust fund is worth £500,000.

£500,000 would be outside S's taxable estate on S's death. More IHT will be saved than if S's estate were entitled to a TNRB of £325,000, since £500,000 is greater than £325,000.

Admittedly, the value of the trust fund (£500,000) would potentially be subject to 10-year and exit charges after the first 10-year anniversary, but that would be a minimal downside.

Former spouse

A gift to a NRB trust on the first death may be advisable where T and/or S are entitled to a TNRB from a former spouse.

The testator (T) may be currently married to S2 and have been married before to S1. T may be entitled to a TNRB from S1, as S1 left the whole of their estate to T.

T should not leave the whole of their estate to S2. There are potentially 3 NRBs:

(a) T's TNRB from S1;
(b) S2's NRB; and
(c) S2's TNRB from T.

On S2's death, their estate will not be entitled to T's TNRB from S1, as S2 was not married to S1. T should, therefore, leave a single NRB legacy to a NRB trust, thereby utilising the TNRB from S1, and leave the residue of the estate to S2.

T has not been married before, but T's spouse (S) has, and is entitled to a TNRB from the estate of their late spouse. T dies before S.

S will not be entitled to two TNRBs, one from each their former spouses (IHTA 1984, s. 8A(5) and (6)). T should, therefore, leave a single NRB legacy to a NRB trust, and the residue of the estate to S.

Form of nil rate band legacy

In the event of my spouse surviving me by the period of 30 days (then but not otherwise) I give free of any tax or duty arising in respect of my death the Nil Rate Sum (as defined below) to my Trustees
"the Nil-Rate Sum' means the largest sum of cash which could be given on the trusts of this clause without any inheritance tax becoming due in respect of the transfer of the value of my estate which I am deemed to make immediately before my death provided that:

(a) when computing the maximum amount my Trustees must take into account any increase effected by section 8A of the Inheritance Tax Act 1984 in the nil-rate band maximum (as defined in that section) that results from my Trustees making a claim under that section for the transfer of the unused nil-rate band of any

spouse of mine who has died before me and I direct my Trustees to make such a claim;

(b) *any other gifts made by this will or any codicil to it shall have priority to this one*

The wording in (b) makes it clear that if, say, the NRB is £325,000, and there are other chargeable gifts in the Will of £100,000, the amount of the NRB legacy is £225,000, and not £325,000, so that no IHT is payable (see *RSPCA v Sharp* [2010] EWHC 268 (Ch) where the issue of priority was not made express).

Legacy to include TNRB

The draft clause in the previous paragraph assumes that the intention is to maximise the legacy to the greatest possible value, so as to include the TNRB. HMRC accept that a gift of the maximum amount which could be given without inheritance tax becoming payable in respect of the estate will allow "the uprated nil rate band to be transferred" (IHTM43065). This is no doubt correct on the basis that a gift of such a maximum sum should be construed, in the absence of any contrary intention, as a gift of the maximum amount that can be given without any limitation, i.e. including any nil rate band or relief which would have the effect of maximising the legacy if it applied (see *The Woodland Trust v Loring* [2014] EWCA Civ 1314). However, it would be advisable to put the matter beyond doubt, if this is the intention.

The testator might, however, want to impose a cap or upper limit on the value of the NRB legacy, as the surviving spouse might otherwise be left with assets of insufficient value. If that is the case, a clause imposing an upper limit should be inserted.

If the testator does not want the NRB legacy to include the TNRB, that should be made express, or a cap should be imposed, e.g. "but so that this sum shall not exceed £[*amount*]".

Legacy to include downsizing addition

It may be possible to include a cash gift to the testator's direct descendants which will take advantage of any downsizing addition to which the testator may be entitled on death. The downsizing addition is a component of the RNRB which is available where the deceased has disposed of their residence, with the result that they own no residential interest on death, or only a lower-value interest which does not take full advantage of the RNRB. Where the downsizing addition is available, the testator can make a cash gift of the amount of the addition to direct descendants of the testator, such as children or grandchildren, in such a way that it is "closely inherited", e.g. absolutely or on IPDI trusts. A gift to a discretionary trust would not, however, qualify.

If, therefore, the testator wishes to make a nil rate band gift of the largest sum that may be given without inheritance tax becoming due upon trust for their children or grandchildren absolutely, or on IPDI trusts, it would be advisable to state explicitly whether the gift includes any downsizing addition to which the testator may be entitled:

> *And furthermore if a downsizing addition would be available to me if a claim for the same was made under section 8L of the Inheritance Tax Act 1984 such downsizing addition shall also be taken into account and I direct my trustees to make a claim under section 8L of the Inheritance Tax Act 1984 for any downsizing addition available to me and to make such nomination or nominations under section 8H of the Inheritance Tax Act 1984 as results in the maximum downsizing addition available to me*

Unwinding a NRB trust

One reason for utilising a NRB trust is that it can always be unwound, and the whole of the estate appointed to the surviving spouse or civil partner (S), absolutely or on IPDI trusts. S will then be entitled to claim the TNRB.

T dies in 2021, leaving a NRB legacy to discretionary trustees for the benefit of their spouse, S, and their children and grandchildren.

In 2022 (within 2 years of T's death) the trustees determine to wind up the NRB trust and to distribute the whole of T's estate to S absolutely, or on trust for S for life.

The NRB trust can be unwound by an appointment made within 2 years of T's death. An appointment out of a discretionary will trust to a surviving spouse, absolutely or on IPDI trusts, made within 2 years of death, will be an exempt transfer under IHTA 1984, s. 18, by virtue of s. 144. Even though the appointed property will form part of S's taxable estate, the TNRB will be available to S's personal representatives on their death.

The appointment will give rise to a deemed CGT disposal if S becomes absolutely entitled to the trust property (TCGA 1992, s. 71(1)). Hold-over relief under TCGA 1992, s. 260(2)(a) will not be available since such relief only applies to IHT chargeable transfers (which will not be the case as the transfer will be deemed to be exempt).

However, the gain since death may not be substantial. In any event, an appointment made during the course of administration will not give rise to a CGT charge as it will amount to a disposal to S as a legatee at probate value (CGT Manual, 31430; TCGA 1992, s. 62(4)).

Share in matrimonial home

One disadvantage of a NRB trust is that it may have to be funded by the appropriation of the whole or part of the testator's share in the matrimonial home, there being insufficient cash or other assets to satisfy the legacy. There is a perceived danger, in such a case, that the surviving spouse or civil partner (S) will be treated as having enjoyed an IPDI in the testator's share in the matrimonial home, by virtue of S's occupation of the home. If that were so, the full beneficial interest in the matrimonial home would be treated as being comprised in S's estate on their death. This would defeat the object of the NRB trust, which is to ensure that trust fund does not form part of S's estate on death.

Debt or charge scheme

Prior to the introduction of the TNRB, it was, therefore, common practice to avoid any question of the surviving spouse or civil partner (S) having an interest in possession in the share of the deceased testator (T) in the matrimonial home by empowering the executors to satisfy the NRB legacy by requiring the NRB trustees to accept in place of all or any part of the legacy:

(a) a binding promise of payment by S, or by trustees holding upon life interest (IPDI) trusts for S ("the debt scheme"); or
(b) the benefit of a charge over the estate's share in the home, securing repayment of such a debt ("the charge scheme").

The executors would assent T's share in the matrimonial home, to S, or to trustees on IPDI trusts for S, subject to:

(a) a promise from S, or from the trustees holding upon IPDI trusts for S, to pay the NRB legacy to the NRB trustees; or
(b) subject to a charge over T's share in the matrimonial home securing repayment of the NRB legacy.

In this way, the asset of the NRB trust is a debt or a charge, and not a share in the matrimonial home. S would not have an interest in possession in the trust's share in the home, as the NRB trust would not own a share, but instead would be entitled to a charge or debt.

The objective is that the debt owed or charged to the NRB trustees should be deductible as a liability of S's estate on S's death. In principle, the debt would be deductible, having been incurred for consideration in money or money's worth (IHTA 1984, s. 5(5)), i.e. in return for the NRB trustees foregoing the right to the immediate payment of the NRB legacy. The debt would be deductible as a liability of S's estate, even when owed by trustees holding on IPDI trusts for S.

There are CGT advantages. S would be entitled to PPR relief in respect of the whole beneficial interest in their home. The tax-free uplift would also apply on S's death.

Complications of debt/charge scheme

Both the debt and the charge schemes had, and have, numerous complications:

(a) The debt is customarily repayable on demand so as to avoid any argument that S had an interest in possession in the debt during their lifetime. However, repayment of the debt would be the last thing that S would actually want.
(b) In practice, the repayment of the debt would not be demanded by the NRB trustees during S's lifetime. However, this gives rise to a risk that HMRC may claim that the debt is a sham.
(c) It would be in the interests of the beneficiaries of the NRB trust that the debt should carry interest or be index linked, even if payment is deferred to death, thereby increasing the amount of the deductible liability in S's estate. However, interest (even if rolled up to death) is subject to income tax in the hands of the NRB trustees. HMRC are adamant that any indexation element is also liable to income tax.
(d) HMRC consider that SDLT is payable when the executors assent T's share to the NRB trustees in consideration of the trustees accepting a promise of payment from S, or from the trustees of the residuary estate holding upon IPDI trusts for S. The only way of avoiding a SDLT charge, in their view, is for the executors to charge the share with payment of the NRB legacy on a non-recourse basis, i.e. on terms that no one is personally liable to repay the debt, and to assent the share to S, or to the trustees of the residuary estate, subject to the charge.

(e) FA 1986, s. 103 can apply to disallow deduction of the debt on the death of S, if S had funded the acquisition of T's share during their joint lifetimes. That may or may not be the case. This problem can, in any event, be avoided by the executors charging the share on a non-recourse basis, and assenting it subject to the charge, to trustees upon IPDI trusts for S.
(f) There need to be minutes of meetings of the NRB trustees to show that the trustees are actively managing the trust, and exercising their discretion not to demand repayment of the debt from S on the basis that they are a beneficiary of the trust. There also need to be provisions in the Will exonerating the NRB trustees from liability in not demanding repayment.
(g) The debt has to be repaid following the death of S, rather than being left outstanding or released, if it is to be deductible unless there is a real commercial reason for the debt not being discharged (IHTA 1984, s. 175A).
(h) The gift of a debt or charge to a NRB trust will not attract the RNRB. It does not involve a gift of a qualifying residential interest comprised in the deceased's estate to direct descendants in such a way that it is "closely inherited".

NRB trust funded by share of matrimonial home

One way of avoiding the complications outlined in the last paragraph is to ensure that T's share in the matrimonial home is not an asset of the NRB trust during the period of 2 years after T's death, so that there is no question of S having an IPDI in T's share.

S will only have an IPDI in T's share if S became beneficially entitled to an interest in possession:
(a) immediately on the death of T (IHTA 1984, s. 49A); or
(b) during the 2-year period after T's death.

If S becomes entitled to an interest in possession within 2 years of T's death, S's interest in possession will be back-dated to T's death pursuant to IHTA 1984, s. 144. S will be deemed to have acquired an IPDI, with the result that T's share would be deemed to form part of S's estate.

An IPDI can, however, be avoided by taking the following steps:

(a) T's executors should only appropriate T's share in the home to the NRB trustees after 2 years has passed since T's death.
(b) The NRB trustees should, again outside the 2-year period, appoint a life interest in the home to S expressly conferring rights of occupation.

In those circumstances, the NRB trustees will not have done anything within 2 years of death to confer any occupation rights on S. Indeed, T's share will not even form part of the trust fund prior to the appropriation to the trustees (outside the 2-year period). S will have been in occupation solely by reason of their own share. The only action by the NRB trustees to confer a right of occupation will take place after the expiry of the 2-year period.

In this way the NRB trust's share will not form part of S's estate for IHT purposes. It will be comprised in a NRB trust.

The appointment on interest in possession trusts for S, outside the 2-year period, would not in itself give rise to any IHT charge. The share in the home would remain relevant property, so that there would be no exit charge.

An added bonus is that principal private residence relief should be available, in respect of the trust's share, on the sale of the home. S will be entitled to occupy under the terms of the settlement, and principal private residence relief should be available (TCGA 1992, s. 225).

BUSINESS AND AGRICUTURAL PROPERTY

Gift to chargeable beneficiaries

Property qualifying for business property relief (BPR) or agricultural property relief (APR) should not be given to the surviving spouse or civil partner (S). The effect of such reliefs is to reduce the value of the relieved property by 100% or, in some cases, 50%. A gift to S would be exempt in any event, but the relief may be wasted if it is no longer available on S's death.

Business and agricultural property should, therefore, be left to chargeable persons. It is, therefore, not uncommon to include business or agricultural property in a gift to a NRB discretionary trust.

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T has business property worth £1m qualifying for 100% relief.
T has an unused NRB of £325,000.

T can give their business property worth £1m, plus a NRB legacy of £325,000, to NRB trustees, without incurring any charge to IHT. The residuary estate can be left to the surviving spouse or civil partner (S) absolutely or on IPDI trusts.

A cap can be put on the value of the business property passing into the NRB trust if a gift of the maximum sum is likely to reduce the value of the residuary gift to S to an unacceptable degree.

Specific gift

Business and agricultural property should be left by way of a specific gift to the NRB trust, as opposed to a legacy of the maximum amount of cash which can be given without any liability to IHT (even if the executors appropriate business and/or agricultural property in satisfaction of the legacy). If there is no specific gift, the benefit of the relief will be apportioned between the NRB gift and the exempt gift of residue to S (IHTA 1984, s. 39A). 100% of the relief will not apply to the business/agricultural property.

NRB gift of property if qualifying for relief

T owns some land and shares in a company.
There is some doubt as to whether, or to what extent, the farm and shares qualify for BPR and/or APR. T has a spouse or civil partner (S).

The Will could provide that the farm and shares be given to:
(a) NRB trustees if and to the extent that the farm and shares qualify for relief, or they qualify for 100% relief; and
(b) to S if and to the extent that the farm and shares do not.

This should be avoided. HMRC will refuse to rule on whether or not relief applies, as no tax is at stake. Either BPR/APR, or the spouse exemption, apply.

Gift of business/agricultural property limited to NRB

A specific gift of business and/or agricultural property, plus a cash legacy, up to the value of the NRB, gives rise to significant drafting difficulties, in that:

(a) An asset may attract relief at less than 100%, e.g. at 50%;
(b) An asset may be business property qualifying for 100% or 50% BPR, but part of the value may not attract any relief, being attributable to an "excepted asset", such as cash reserves not needed for business purposes (IHTA 1984, s. 112).
(c) An asset such as a farm may qualify for 100% APR, but only to the extent of its agricultural value.
(d) The executors may not have agreed with HMRC, for some time after death, the value of the assets which qualify for relief.

Form of NRB gift of relievable property

It is, however, possible to provide for a gift of relievable property limited to the value of the NRB, with a top-up gift of a cash sum to the full amount of the NRB, if the reduced value is less than the NRB. The drafting is, however, complicated. It also means that the executors will have the task of valuing property subject to relief.
T could make gifts to the NRB trustees of:

(a) property qualifying for 100% relief on 100% of its value ("Fully Relievable Property");
(b) property which does not qualify for 100% relief on 100% of its value ("Partly Relievable Property") limited to the value of the NRB; and
(c) A top-up gift of cash which, when added to the value of the Partly Relievable Property, is equal to the NRB.

Unlimited gift of business and agricultural property

T might be better advised to give all of their business and agricultural property to a discretionary trust, particularly where there is doubt as to whether, and to what extent, such property may qualify for relief, even though the reduced value of such property may exceed the NRB.

T owns a farmhouse and some land (the Farm) and a business (the Business).

T is not sure whether, or to what extent, these assets will qualify for APR or BPR.
T is married to S and has a number of children.

T could leave the Farm and the Business (whether or not they qualify for relief) to a discretionary trust, with a top-up gift of cash to the value of the NRB.

HMRC will have to rule whether and to what extent the Farm and the Business qualify for BPR and/or APR if the top-up sum is defined as such sum as would not attract an IHT charge, but ignoring for this purpose the gift of the Farm and the Business. It should be possible to obtain a ruling from HMRC within 2 years of death.

If, within 2 years of death, relief proves not to be available, the Farm and the Business can be distributed within that 2-year period to S, absolutely or for life, so that the spouse exemption applies, by virtue of IHTA 1984, s. 144. S can make gifts, or S's life interest can be terminated in whole or in part, by way of PETs to the children.

If, on the other hand, it becomes apparent that relief is available, the Farm and the Business can be retained in the trust, or appointed to the children absolutely or on life interest trusts. If retained in the trust, 10-year and exit charges should not be an issue so long as the trustees own property which qualifies for 100% BPR and/or APR.

Two bites of the cherry

T leaves business assets to a discretionary trust, and the residue of their estate to their spouse or civil partner (S) who is involved in the business, and has a significant interest in their own right.

HMRC rule within 2 years of H's death that 100% BPR applies to T's business assets.

S could purchase from the trustees the business assets, pursuant to an arm's length transaction, perhaps using money forming part of the residuary estate. If S is one of the trustees, T's Will should expressly authorise S to purchase property comprised in the estate.

If S survives for 2 years after the purchase, the business assets will be eligible for 100% relief in S's estate. Relief will have been obtained twice over ("two bites of the cherry"). Relief will have been available on T's death, even if the business assets are sold to S soon after T's death. Relief may be available again on S's death if S still retains the business assets, and they still qualify for BPR.

S must, however, survive for 2 years from the purchase of the business assets if BPR is to be available (IHTA 1984, s. 106). If S does not, the costs of implementing the scheme would have been wasted. Such costs may include CGT on the sale of the business assets (if they have increased in value since death) and Stamp Duty (0.5% on shares) or SDLT in respect of land.

WILL TRUSTS

Residuary estate settled on IPDI trusts for surviving spouse or civil partner

It is common for the residuary estate (subject to any NRB gift) to be settled upon flexible life interest trusts for the surviving spouse or civil partner (S).

T leaves their residuary estate on life interest trusts for their spouse, S, remainder to T's children by T's first marriage.

The trustees have power during S's lifetime to appoint capital to S, if S needs it, and to appoint in favour of a wider class such as T's children. T can leave a suitable letter of wishes giving guidance to the trustees as to their wishes.

The tax consequences are:

(a) On T's death, S will be entitled to an IPDI. An IPDI is a "qualifying interest in possession" with the result that S will be treated for IHT purposes as beneficially entitled to the property in which the interest subsists (IHTA 1984, s. 49(1)). T will, therefore, be treated as having made on death an exempt transfer of the settled property to S. No IHT will be payable on T's death.
(b) On S's death the settled property will form part of S's estate (IHTA 1984, s. 4, 5). S's estate will be entitled to the TNRB as the whole estate has been settled on IPDI trusts for S. The transferable RNRB (the brought-forward allowance) will also be available on S's death, if T's residuary estate includes T's residence or share

thereof. There will be no exit and 10-year charges during S's lifetime. There will be a CGT-free uplift on S's death.

In this way, T's residuary estate can be left to S upon life interest trusts, free of IHT. There will be no need to pay IHT on T's death (in contrast to the position where residue exceeding the nil rate band is settled on discretionary trusts). There will be no 10-year charges while the trust property remains settled during S's lifetime. However, T can ensure that the trust property passes to their children on S's death (subject to any advances or appointments made by the trustees).

If appropriate, the IPDI trust can always be unwound by an appointment by the trustees to S absolutely without any charge to IHT (IHTA 1984, s. 53(2)).

Termination of IPDI of spouse

If T settles their residuary estate upon trust for S for life, S's life interest can be terminated, in whole or in part, by the trustees appointing in favour of, say, S's and/or T's adult children absolutely. If appropriate, the power to terminate S's interest can be made subject to S's prior written consent.

S will be treated as having made a transfer of value equal to the value of the property in which S's IPDI subsisted (IHTA 1984, s. 52). However, the termination will be a PET, being in favour of an individual or individuals (IHTA 1984, s. 3A(1A)(c)(i),(6) and (6A)). There is, therefore, the opportunity to save IHT if S survives for 7 years. There would be a CGT charge, in respect of any gain since T's death, on the children becoming absolutely entitled against the trustees (TCGA 1992, s. 71). However, if the appointment is of residue or a share of residue, before the completion of administration, there will not be a charge on the appointment (CGT Manual 31430) or on the subsequent appropriation of assets to the children as legatees (TCGA 1992, s. 64(2)). The trustees can appoint the whole, or a share of, residue, whether residue is ascertained or not, unless, as a matter of construction, the will clearly demonstrates a contrary intention (IHT Manual, 35181).

T could have left the estate to S absolutely, and S could make PETs to the children. S would then have retained control. However, if, say, S is likely to lose capacity, a life interest trust is a better option. The use of a trust will safeguard against the danger that S may make gifts at a time when their capacity is in doubt. There will be no need for an application to the Court of Protection to approve gifts to the children. The assets of the trust (other than any income actually paid to S) will also be immune from any liability to contribute to care home fees.

Precatory gifts

T should not leave their estate to S absolutely expressing a wish that S should transfer the whole or part of it to the children, even if S is in good mental health, and can be trusted to carry out T's wishes. If S transfers the property within 2 years of T's death, IHT would be charged as if T had left the property directly to the children (IHTA 1984, s. 143). The spouse exemption would be lost, and S will not have made a PET. It would be better to have left the estate on terminable IPDI trusts for S.

Termination of IPDI of 2nd spouse

T is married to S, who is much younger.
S has money of their own.
T has children of a previous marriage, whom T wishes to benefit on their death.

T might be advised to make a Will leaving their residuary estate upon trust for S for life, but giving the trustees an overriding power of appointment in favour of a class of beneficiaries, including T's children.

Shortly after T's death, the trustees could terminate S's life interest, in whole or in part, in favour of the children absolutely, giving rise to a PET. Indeed, T might leave a letter of wishes asking the trustees to terminate S's life interest, in whole or in part, soon after T's death, in favour of T's children, if appropriate. Alternatively, the Will can provide that S's interest should terminate automatically after a fixed period.

If S survives for 7 years (as is likely) no IHT will be payable on the appointments in favour of the children. T's estate will have passed to T's children, free of IHT, which would not have been the case if T had left the estate directly to the children on T's death.

The trustees would, in the case of a termination of S's life interest giving rise to a transfer of value exceeding S's NRB, need to insure against S's death within 7 years and/or make a sufficient retention to pay the IHT liability in that event.

S's own NRB might also be used up if S then fail to survive for 7 years, to the detriment of the beneficiaries of S's estate such as S's own children by a previous relationship. It might, therefore, be appropriate to consider the inclusion of a legacy to S's children.

T should also be advised about the possibility of a claim by S under The Inheritance (Provision for Family and Dependants) Act 1975 if reasonable provision is not made for S as a result of the termination of S's IPDI.

Termination of IPDI and reservation of benefit

Care should be taken to ensure that a benefit is not reserved by S on the termination of S's life interest. If there is a reservation of benefit at the date of S's death, the settled property will be deemed to form part of S's estate.

T settles their estate, including their interest in the matrimonial home, on trust for S for life.
The trustees terminate S's life interest in the matrimonial home in favour of T's children.
S continues to occupy in the matrimonial home.

The termination of S's life interest during S's lifetime would be deemed to be a gift by S of the settled property in which S's interest in possession subsisted (Finance Act 1986, s. 102ZA). This is so even though S will not have made a gift: S's interest will have been terminated by the trustees.

S will have reserved a benefit in the matrimonial home by virtue of their occupation. On S's death the home will form part of S's estate, even if S has survived for 7 years since the termination of their interest.

Lease carve out

S will not be treated as having made a gift, on the termination of S's interest, for the purposes of Finance Act 1986, s. 102A (which applies to a gift of interest in land occupied by a donor who has retained an interest), as opposed to s. 102 (general reservation of benefit provision).

The trustees could, therefore, grant a 20-year lease in the matrimonial home to a nominee for themselves, at no rent, and then terminate S's interest in possession in the freehold reversion in favour of S's children absolutely. S will be deemed to have made a PET of the value of the freehold reversion. PPR relief will be available on the disposal.

S will retain an interest in possession in the lease. However, there will be no reservation of benefit in respect of the freehold reversion because:

(a) S will not have made a gift with a reservation for the purposes of FA 1986, s. 102, as a lease will have been carved out prior to the gift of the freehold; and
(b) Although S will be deemed, by FA 1986, s. 102ZA, to have made a gift of the freehold reversion, on the termination of S's life interest, that will not be the case for the purposes of FA 1986, s. 102A. Nor will S have disposed of an interest in land for the purposes of the POAT charge.

S could, therefore, continue to occupy by virtue of the lease (the value of which will diminish over time) without a reservation of benefit.

There will, however, be a CGT charge, in respect of the children's freehold reversion, on the eventual sale of the house. However, the scheme can be modified to avoid such a charge, by S retaining a 5% interest in the freehold reversion, with the other 95% being appointed to the children.

General power of appointment

T proposes to make a Will settling their residuary estate on life interest trusts for their surviving spouse (S).
T and S have only one child, C, who is something of a spendthrift.
They do not want C to become absolutely entitled to T's residuary estate on S's death (assuming that S survives T) but would rather that C had a terminable life interest.

The problem is that, on S's death, C's life interest will not be an IPDI, since C's interest will not arise on T's death. The life interest trust for C will be a relevant property settlement, subject to 10-year and exit charges.

T could, by their Will, give S a general power of appointment exercisable by Will in favour of any person. If S exercises that power to settle the trust fund, after S's death, on trust for C for life, C would become entitled to an IPDI outside the relevant property regime.

Alternatively, even if S is not given a general power of appointment, the trustees could appoint the trust fund to S absolutely with no IHT charge (IHTA 1984, s. 53(2)). S can then set up an IPDI trust under their Will in favour of C.

Generation skipping

T's spouse is deceased.
T has one adult child, C, who is married, and well provided for.
T has two grandchildren aged 21 and 23.

T could leave their estate, or a substantial legacy, to trustees upon flexible IPDI trusts for the grandchildren. The grandchildren's interests would qualify as IPDIs. IHT would be payable on H's death. However, that would be the case if the estate were left to C.

The advantage of leaving the estate to grandchildren on IPDI trusts is that no IHT will be paid on C's death in respect of T's estate. A further IHT charge can be deferred for many years, i.e. until the deaths of the grandchildren. 10-year, or exit charges, will not apply during the currency of the trust. If the trustees advance or appoint the capital of the share of a grandchild to that grandchild absolutely, that would not give rise to any charge to IHT (IHTA 1984, s. 53(2)). However, there would be a CGT disposal, the gain on which cannot be held over, unless the assets qualify for business hold-over relief pursuant to TCGA 1992, s. 165.

The income payable to the grandchildren can be limited, if the trustees are given power to invest in low or even non-income producing assets.

Bereaved minor's trust ("BMT")

T is single.
T has a child, C, aged 3.
T wishes to leave the whole of their estate (which exceeds the NRB) to C.
T dies when C is 4.

T could make a Will leaving their estate to C contingently on attaining the age of 18 years.

So long as the Will provides that:

(a) The capital and income vest at 18; and
(b) While C is living and under the age of 18:
    a. capital can only be applied for C's benefit; and
    b. C is either entitled to the income (if any), or no such income may be applied for the benefit of any other person.

the trust will qualify as a BMT within IHTA 1984, s. 71A.

If C is entitled the capital at 18, but is given an immediate entitlement to income (s. 31 of the Trustee Act 1925 being excluded) the trust can still be a BMT.

There are IHT advantages:

(a) There will be no IHT charge on C's death before 18;
(b) There will be no 10-year or exit charges while C is under the age of 18 (there will, therefore, be no 10-year charge when C is 14);
(c) There will be no exit charge on C becoming entitled to the settled property at 18, or to an interest in possession in the settled property, on or before attaining the age of 18.

The trust will, in effect, be IHT-free until C attains the age of 18. Hold-over relief is also available on any occasions when C becomes absolutely entitled (TCGA 1992, s. 260(2)(da)).

There can be a BMT for a number of bereaved minors provided that they are alive at the date the trust takes effect and under the age of 18. The shares of each minor can be unequal, and can be varied. The trust can include a power of advancement over the whole trust fund.

Disadvantages of a BMT

BMTs are not particularly attractive to a testator (T):

(a) The bereaved minor must be a child of T (thus excluding grandchildren, including those who only benefit by substitution on the death of their parent before T).

(b) There is limited flexibility:

   a. Income and capital cannot be paid to anyone other than a bereaved minor (subject to a de minimis exception: the lower of £3,000 and 3% of the value of the settled property can in any one year from 6 April be applied otherwise than for the benefit of the bereaved minor);
   b. A bereaved minor cannot be revocably excluded from benefit, and then reinstated before the age of 18.
   c. A bereaved minor's share cannot be increased or decreased once they have attained the age of 18, and an overriding power of appointment cannot be included so that a bereaved minor's absolute entitlement at 18 can be defeated.

(c) The bereaved minor must be entitled to the trust capital at 18 (which may be regarded as too young an age).

However, the trustees can exercise a power of advancement to make a settled advance deferring the bereaved minor's entitlement beyond 18 provided that they consider that this is for the benefit of the child (see *Wright v Gater* [2011] EWHC 2881 (Ch)). The statutory power of appointment under s. 32 of the Trustee Act, or an express power to like effect, is consistent with a BMT (IHTA 1984, s. 71A(4)).

There will be no IHT charge on the making of such a settled advance (IHTA 1984, s. 71B(2)(c)). However, the trust will then be subject to the relevant property regime (unless it qualifies as an 18-25 trust).

18-25 trusts

T does not want C to be entitled to their estate at 18.
T wants to leave their estate (which exceeds her NRB) to C on attaining the age of 25.
C is 4 when T dies.

T can leave their estate to C contingently on attaining the age of 25. Such a trust can qualify as an 18-25 trust, introduced by IHTA 1984, s. 71D in order to counter the criticism that the vesting of capital at 18 is often inappropriate.

However, 18-25 trusts can only be set up by will, and T must be the parent of the beneficiary.
C must become entitled to the capital on or before attaining the age of 25.

Capital and income cannot be applied for the benefit of anyone other than C while C is under the age of 25 (subject to a de minimis exception). C can become entitled to the income at 18. However, C must not become entitled to the income immediately after S's death. In that event, C would have an IPDI, which takes precedence over an 18-25 trust. The Will should, therefore, give the trustees power to accumulate income, or to apply it for the benefit of C, but no other person, until he attains the specified age.

As in the case of a BMT, an 18-25 trust can be for the benefit of a number of beneficiaries, and can include a power of advancement.

Tax analysis of 18-25 trusts

While C is under the age of 18, the trust is exempt from IHT as is the case with a BMT. There will be no 10-year charge when C is under the age of 18, nor any charge on distributions for C's benefit while C is under that age.
There is no 10-year charge when C is is aged between 18 and 25.

However, there will be an IHT charge under IHTA 1984, s. 71F(2), if, after C has attained the age of 18:

(a) C becomes absolutely entitled to the trust property;
(b) C dies; or
(c) property is advanced for the benefit of C.

The charge is calculated in the same way as an exit charge under the relevant property regime. The rate increases depending upon the number of quarters which have passed since C's 18th birthday. The maximum charge is 4.2% if C becomes entitled to capital at 25.

Flexibility

An 18-25 trust introduces a degree of flexibility. The trustees can:

(a) advance to C at 18 without any IHT charge;

(b) advance at any age between 18 and 25; or
(c) advance at 25.

The longer they wait, the higher the charge.

There is the added advantage that hold-over relief will be available on C becoming absolutely entitled on or before attaining the age of 18 (TCGA 1992, s. 260(2)(da)) or between 18 and 25 (TCGA 1992, s. 260(2)(a)).

There is yet further flexibility in that the trustees can make a settled advance postponing entitlement to capital beyond 25, albeit at the cost of an exit charge. The continuing trusts will be within the relevant property regime subject to further 10-year and exit charges. This may be a price worth paying if C cannot be expected to manage capital responsibly.

Conclusion on BMT and 18-25 trusts

An 18-25 trust (with the potential to defer entitlement beyond 25 by a settled advance into a relevant property trust) is probably preferable to a BMT. It defers capital entitlement at an acceptable cost.

However, both forms of trust are only going to assist in the comparatively rare case where a parent dies leaving young children and there is no surviving spouse.

A discretionary trust might be preferable where the value of the settled property is within the NRB. It is more flexible.

IPDI trusts for minor children

As an alternative to an 18-25 trust, a flexible IPDI trust for minor children should be considered. In this way, capital entitlement can be deferred beyond 25 for the whole life of the child.

T leaves their residuary estate on flexible life interest trusts for T's child, C. C is 4 when T dies.
C will become entitled to an IPDI on T's death, even if C is under the age of 18.

C has an IPDI outside the relevant property regime for the remainder of their life, assuming that the trust continues. There would be no IHT charge if the capital of C's share is advanced to C absolutely (IHTA 1984, s. 53(2)).

C will not be able to give good receipt for income until C is 18. The trustees can, therefore, if they so wish, retain income while C is under the age of 18. However, Trustee Act 1925, s. 31 should be excluded, so that the trustees have no discretion to accumulate income (which would be inconsistent with an IPDI).

C will be able to give good receipt in respect of income at 18. However, the trustees can, if the trust deed gives them power to do so, invest in assets which produce little or no income. C will not have a right to the capital on or before attaining the age of 25 (as in the case of an 18-25 trust). The trustees can advance capital to C at a later age, or even advance on trusts for C's children.

A disadvantage of an IPDI trust, as against an 18-25 trust, is that hold-over relief will not be available on C becoming absolutely entitled unless the assets are business assets within TCGA 1992, s. 165. Also IHT will be payable on C's death at the full death rates (which would not be the case with an 18-25 trust if C died before the age of 25). However, these disadvantages may not be significant.

In the case of minor grandchildren, an IPDI is a good option. It should defer payment of IHT for many years.

2-year discretionary trust

In some cases a testator may wish to leave the decision as to the ultimate distribution of their estate to trustees (of which a surviving spouse or civil partner may be one) subject to having regard to the testator's guidance as set out in a letter of wishes.

A common solution is to take advantage of IHTA 1984, s. 144 which will allows appointments out of a relevant property trust (such as a discretionary trust) within 2 years of the testator's death to be read back to the date of death so that (a) there is no charge on the appointment itself; and (b) IHT is charged on death as if the testator had left the property as it is held after the appointment.

The requirements of IHTA 1984, s. 144 are that:

(a) property is settled by will; and
(b) within two years of death; and
(c) before an interest in possession has arisen;
(d) an event occurs that would otherwise be chargeable to IHT.

If these conditions are satisfied, no IHT is charged on the event, which is automatically read back into the will. If, therefore, the trustees of a discretionary trust, created by a will, appoint to the surviving spouse or civil partner (S), absolutely within 2 years of death, the spouse exemption will apply. An exit charge would have applied. However, the appointment is deemed to be retrospective, so that there is an exempt transfer between spouses (S being absolutely entitled). The same result applies if the appointment is made within 2 years of death on trust for S for life. S will be deemed to have acquired an IPDI pursuant to an exempt transfer (IHTA 1984, s. 144(3) and (4)).

There is no need to provide that the trust should terminate after 2 years. However, in some cases it is provided that any appointment must be exercised within 23 months of death.

Frankland trap

There was previously a trap for the unwary. An appointment made within 3 months of death to a beneficiary absolutely does not give rise to an exit charge (IHTA 1984, s. 65(4)). IHTA 1984, s. 144(1) formerly did not apply to an appointment out of a discretionary trust to a beneficiary absolutely which does not give rise to an exit charge.

The consequence was that, in the case of an appointment to the surviving spouse or civil partner (S) absolutely (as opposed to on life interest trusts) in the first 3 months after death, the appointed fund:

(a) formed part of S's estate on their death; but
(b) the TNRB was not available to S's PRs (because S would not be deemed to have become entitled on the death of the predeceasing spouse or civil partner).

Hold-over relief under TCGA 1992, s. 260(2)(a) was also not available in respect of an appointment within the first 3 months (if, for any reason, the value of the appointed property had increased substantially since death).

However, the effect of s. 144(1)(b), in respect of deaths occurring on or after 10 December 2014, is that an appointment to S absolutely within 3 months of death will be retrospectively exempt (IHTA 1984, s. 144(1)(b) as amended).

The Frankland trap has never applied to an appointment on IPDI trusts since the retrospective effect of s. 144 applies even if there is no exit charge (IHTA 1984, s. 144(3) and (4)).

Advantages of IHTA 1984, s. 144

IHTA 1984, s. 144 affords a testator (T) a degree of flexibility in that T can leave their estate on discretionary trusts with a view to appointments being made within 2 years of T's death. The trustees can then deal with the property in the most tax-efficient way, taking into account the current circumstances and legislation within 2 years of death. The trustees can decide, having regard to the current circumstances and any letter of wishes, how best to distribute the trust fund, e.g. by appointing within 2 years of death:

(a) the whole or part of the trust fund to an exempt beneficiary, such as a charity or a surviving spouse or civil partner;
(b) an IPDI to a younger beneficiary (thus taking the trust out of the relevant property regime and deferring any further IHT charges for many years); or
(c) to any beneficiary dependent upon circumstances such as financial need, bankruptcy, divorce etc.

Common uses of s. 144

2-year discretionary trusts are often used:

(a) to receive property which may or may not qualify for BPR or APR on the death of the testator (T) (with a view to appointing to T's children if BPR/APR is available and, if not, to T's surviving spouse or civil partner (S));
(b) to receive T's share in the matrimonial home (so that the trustees can determine within 2 years of death whether or not to appoint to direct descendants, thereby taking advantage of the RNRB, alternatively to appoint to S);

(c) to receive a NRB legacy which can be appointed to S, if so desired, within 2 years of death, thereby obtaining the spouse exemption.

Disadvantages of 2-year discretionary trusts

There are, however, a number of disadvantages to, and points to watch in respect of, a 2-year discretionary trust:

(a) T will be giving control over the distribution of the estate to third parties, i.e. the trustees.
(b) CGT hold-over relief under s. 260(2)(a) IHTA 1984 will not apply to distributions within the 2-year period after death with the result that any gain since death will be taxable. However, an appointment made during the 2-year period, prior to the completion of administration, is treated by HMRC as a disposal to a legatee at probate value, with the result that no CGT will be payable until the legatee disposes of the asset (CGT Manual 31430).
(c) Full IHT has to be paid prior to the grant of probate, even if there is subsequently a distribution which is exempt, e.g. to a spouse. This may give rise to cash flow problems unless the power of appointment is exercised prior to the grant.

The appointment could, however, be made before IHT becomes payable 6 months after the end of the month in which the testator dies (IHTA 1984, s. 226 and 233). The Will should expressly provide that the power of appointment may be exercised notwithstanding that there has been no grant of probate and that the administration of the estate has not been completed, and that it is exercisable by the executors for the time being.

Pilot trusts

Pilot trusts have commonly been used where it is desired to avoid 10-year and exit charges on relevant property settlements of substantial value.

T (who has made no chargeable transfers in the last 7 years) has an estate of £1.5M after IHT. T is single, but has numerous children and grandchildren.
T wishes to leave their estate on death to trustees on long-term discretionary trusts for T's children and grandchildren, their spouses and civil partners.

The problem is that the discretionary trust, settled by her Will, will be subject to 10-year and exit charges, as £1.5 M is well in excess of the nil rate band.

The classic advice has been that T should set up a number of pilot settlements during T's lifetime:

Day 1 £10 to Trust 1
Day 2 £10 to Trust 2
Day 3 £10 to Trust 3
Day 4 £10 to Trust 4
Day 5 £10 to Trust 5

The £10 settled on each of Days 1 to 5 must actually be paid. Although not strictly necessary, it is common practice to ensure that each trust is not identical, e.g. by varying the class of beneficiaries.

By T's Will T would leave legacies, free of tax, comfortably within T's NRB on death (say of £300,000) to each of the 5 pilot trusts. The value of the property in each Trust would, therefore, be within the NRB.

Each Trust would have its own NRB. However, the total sum settled (£1.5M) would far exceed the NRB.

Taxation of pilot trusts

Under the law, as it was before Finance (No 2) Act 2015, each of the pilot trusts enjoyed its own separate NRB provided that:

(a) T did not make any chargeable transfers in the 7 years prior to the commencement of the trusts; and
(b) T also made no chargeable transfers in the 7 years prior to their death; and
(c) The additions to Trusts 1 to 5 were made on the same day, which would be the case, as they are made on death.

It is a key part of the tax planning that the additions are made on the same day. This is because IHTA 1984, s. 67 provides that, where property is added to a settlement, the cumulative total of the settlement is the aggregate value of the chargeable transfers made by the settlor in the 7 years ending on the day on which an addition is made, if this is greater than the value of the chargeable transfers made by the settlor in the 7 years prior to the commencement of the settlement (IHTA 1984, s. 67). However, crucially, additions made on the same day as each other are disregarded (IHTA 1984, s. 67(3)(b)(i)).

Therefore, the cumulative total of each of Trusts 1 to 5 did not take into account the value of the additions made to the other Trusts, as those additions are made on the same day, i.e. on T's death.

Same-day additions

The Finance (No 2) Act 2015 introduced a new provision (IHTA 1984, s. 62A) to counteract the use of pilot trusts, and generally to target additions to multiple trusts.

The efficacy of pilot trusts depended upon substantial value being added to each pilot trust on the same day, e.g. on the death of T.

The Finance (No 2) Act 2015 counteracted the benefits of same-day additions to multiple settlements by providing that, in calculating 10-year and exit charges for each settlement, account is taken of the value of property added by the same settlor on the same day to another relevant property settlement.

Effect of same-day additions

T settled 2 discretionary pilot trusts (settlements A and B) of £10 on consecutive days.
T died leaving £300,000 to each of settlements A and B.
The aggregate value of the property in both settlements on the first 10-year anniversary is £1m.

The hypothetical chargeable transfer (on an exit, or 10-year, charge) in respect of settlement A is increased by:
(a) the £300,000 added to settlement B on the same day that £300,000 is added to settlement A; plus
(b) the £10 initially comprised in settlement B.

The same applies to settlement B. Its cumulative total is also increased by £300,010.

This largely removes the IHT benefits of using pilot trusts to split the value of property settled by Will on discretionary trusts between multiple settlements.

However, there may be some advantage in using pilot trusts, instead of a single settlement, if the value of the property comprised in the settlements has increased substantially by the date of the charge. The value of a same-day addition to Settlement A increases the cumulative total of Settlement B, and vice versa. Notably, it is the value, when added, which is taken into account. Increases in value are ignored.

CHARITABLE GIFTS

Charitable gifts: reduced rate

IHTA 1984, schedule 1A contains provisions which have the effect of reducing the rate of IHT on the chargeable estate from 40% to 36% for estates where 10% or more of the net estate is left to charity.

The deceased's estate is divided into three components:

(a) the survivorship component (the deceased's interest in assets owned as a beneficial joint tenant);
(b) the settled property component (assets in which the deceased had a qualifying interest in possession); and
(c) the general component (all other assets within the deceased's IHT estate except for property treated as part of the estate because of the reservation of property rules).

The components are treated separately and the lower rate of IHT normally applies only to components for which the 10% test is met, and not for any other component.

The division of the estate into the separate components makes it easier for the relief to be obtained since if all the components were to be treated as one, the 10% test would have to be met in respect of the total value of the estate.

However, it is possible to elect to merge components (which might be worthwhile where one component does not meet the 10% test, but the others do so comfortably). Reservation of benefit property forms part of none of the components although it may (if a merger election is made) benefit from the reduced IHT rate.

When determining whether the 10% test is met for any component, it is necessary to calculate the amount given to charity ("the donated amount") as a proportion of the "the baseline amount".

Example where only one component

T has an estate of £850,000 after deduction of liabilities. The estate consists solely of the general component, with no survivorship component and no property component. T has made no lifetime transfers, and the estate has an available nil rate band of £325,000 on T's death. T wishes to give £75,000 to charity, and the remainder of the estate to their child.

Determine the value of the net chargeable estate deducting the value of any exempt gifts including the charitable gift:

£850,000 - £75,000 = £775,000.

Deduct the available nil rate band (including the TNRB, if claimed, deducting chargeable transfers in the 7 years before death, and excluding the RNRB):

£775,000 - £325,000 = £450,000

Add back the value of the charitable gift to find the baseline amount.

£450,000 + £75,000 = £525,000.

The baseline amount is, therefore, £525,000. The donated amount is £75,000 which is more than 10% of the baseline amount of £525,000, i.e. £52,500. IHT is, therefore, applied at a rate of 36%, rather than 40%, on the chargeable estate less the nil rate band, i.e. £450,000 (before applying any RNRB). The tax saving is, therefore, 4% of £450,000, or £18,000, as against the position if the charitable gift were less than 10% of the baseline amount. HMRC have produced a reduced rate calculator at www.hmrc.gov.uk/tools/iht-reduced-rate/calculator.htm.

Where exactly 10% of the net estate is given to charity, each £100 of the legacy will reduce the IHT due on the estate by £76, so that the effective cost of the charitable legacy to the remaining beneficiaries is only £24.

This rate reduction is unlikely to induce a testator who was not intending to make gifts to charity at all to do so. The non-charitable beneficiaries will always receive less than if tne were no charitable legacies.

However, a testator considering giving between 4% to 10% to charity would be advised to give 10% to charity. An increase from 4% to 10% will be at no cost to the non-charitable beneficiaries. The loss will fall entirely on HMRC.

Where the charitable gift falls in the range of 5% to 9%, and is increased to 10%, both the charities and the chargeable beneficiaries will receive more. Indeed, an increase from 9% to 10% will increase the entitlement of the chargeable beneficiaries by 3%, whilst giving the charities an extra 1%.

Form of charitable legacy

1.1 I give [name of charity] such a sum as together with any other gifts to charity made under my will or any codicil shall constitute a donated amount equal to ten per cent (10%) of the baseline amount [in relation to the general component of my estate] OR [the aggregate of the general, survivorship, settled property components and reservation of benefit property of my estate].

1.2 The legacy given by this clause shall in no event:

1.2.1. be less than £[amount] whether or not the lower rate of tax shall be applicable; and

1.2.2. exceed £[amount] (the upper limit) even if in consequence the lower rate of tax shall not apply.

1.3 My executors in making payment of the legacy given by this clause:

1.3.1 shall be entitled to accept in full discharge the receipt of the secretary, treasurer or other officer of the charity concerned;

1.3.2 may appropriate assets not otherwise specifically bequeathed to satisfy (or partly satisfy) this legacy without the consent of any beneficiary under my will or any codicil.

1.4 Terms in this clause have the same meaning as in Schedule 1A IHTA 1984 and the reference to a gift to charity means a gift attributable to property to which section 23 IHTA 1984 applies.

Deed of Variation

It may be appropriate for the chargeable beneficiaries to execute a Deed of Variation so as to increase the charitable legacies to 10% of the baseline amount.

The variation must be notified to "the appropriate person" at the charity (IHTA 1984, s. 142) being the charity to which the property is given or the trustees of the charitable trust. There is no requirement for the charity, or the trustees of the charitable trust, to be a party to the Deed of Variation. However, there must be evidence of awareness by the charity or trustees that property is to be redirected to it/them. Copies of correspondence between the parties showing that the charity or trustees are aware of the arrangements will be sufficient (HMRC Trusts & Estates Newsletter April 2012).

Partial exemption

It is not uncommon for a Will to contain a gift of the testator's (T's) residuary estate after payment of administration expenses (including tax) to:

(a) a chargeable beneficiary, such as the testator's child; and
(b) an exempt beneficiary, such as a charity (or spouse)

in equal or unequal shares.

T leaves their residuary estate of £1m after payment of administration expenses to T's child (C) and to a charity in equal shares. T has no available nil rate band.
Estate: £1m.
Chargeable estate: £500,000 (1/2 share of C).
IHT: 40% x £500,00 = £200,000.

It might be thought that the shares should be calculated by deducting the IHT of £200,000 from the gross estate of £1m, and dividing the net sum of £800,000 by 2, so that C and the charity get £400,000 each (the charity and C paying £100,000 each in tax).

IHTA 1984, s. 41

However, such a result is prohibited by IHTA 1984, s. 41 which provides that notwithstanding the terms of any disposition none of the tax attributable to the value of the property comprised in residue shall fall on any gift of a share of residue if or to the extent that the transfer is exempt with respect to the gift. No part of the IHT can come out of the charity's share.

The IHT of £200,000 must, therefore, come exclusively out of C's share of £500,000, leaving C with £300,000. The charity will be entitled to £500,000. Such a gross division approach is obviously better for the charity. The charity will receive more than C.

If this is what T intends, it would be advisable to make an express direction to that effect:

> *I declare that in determining the shares of the beneficiaries of my residuary estate my residuary estate shall be divided into shares without making any deduction or allowance for the inheritance tax payable by reason of my death and that the shares which are not exempt from inheritance tax shall be reduced by the inheritance tax attributable thereto.*

Ultimate equality

If, however, T wants to ensure that C and the charity receive equal amounts, this can be done by providing:

> *I declare that the entitlement of the residuary beneficiaries shall be determined by grossing up the shares which are not exempt from inheritance tax so that after making any deduction or allowance for*

> *the inheritance tax payable by reason of my death and attributable to my residuary estate the residuary beneficiaries shall receive equal shares so that net of inheritance tax the shares actually received by each of the residuary beneficiaries shall be of equal amounts whether or not any of them is exempt from inheritance tax.*

This will mean that the gift to C will have to be "grossed up" by the amount of the tax thereon, so that C, after deduction of tax, receives the same amount as the charity. Most testators will not want to introduce such complexity. Indeed, if the intention is, say, that C should receive 2/3 of the estate, and the charity 1/3, it would be necessary to direct that the shares should be such that after the deduction of inheritance tax attributable to them respectively the share of C is twice that of the charity. In any event, the mathematical calculations are complicated. There is a calculator at https://www.gov.uk/government/publications/inheritance-tax-grossing-up-calculators.

Grossing up is not prohibited by IHTA 1984, s. 41 as the tax is not coming out of the charity's share. However, the overall amount of the tax payable to HMRC will be increased since the chargeable share will be increased. The charity will also get less.

An express direction for grossing up is required. It will not be implied from a common form direction that administration expenses be paid out of residue, and that the net sum be held upon trust for exempt and non-exempt beneficiaries in equal shares (*Re Ratcliffe* [1999] STC 262).

The same principles apply if the residuary estate is divided between a chargeable beneficiary and a spouse or civil partner (rather than a charity).

RESIDENTIAL NIL RATE BAND

Objective

The policy behind the RNRB was to grant an additional NRB where a deceased person leaves an interest in their home to their children or other lineal descendants. The objective was to meet the criticism that the estates of persons, who are by no means wealthy, were being dragged into the IHT net by virtue only of the historic rise in residential property prices. Why should an ordinary person, who has worked hard all their life, paying tax on income used to finance the purchase of their home, not be able to leave their home to their children free of IHT?

The solution was to increase the value at which IHT is charged at a nil rate, provided that the deceased's estate includes an interest in their home, and that interest is inherited by their close family. Unfortunately, the legislation is of mind-blowing complexity and almost impossible, even for a lawyer, to decipher, let alone apply.

Downsizing addition

Under the original legislation, the RNRB was only available if the deceased person owned an interest in their residence, or former residence, immediately before their death. This prompted a concern that this would penalise elderly persons who might not own a residence on death, or only one of minimal value. This could be a disincentive to those who might otherwise wish to downsize to a less valuable home, or to sell and move into a rented property or residential care.

Accordingly, the Finance Act 2016 contained additional provisions extending the RNRB to cases where the deceased had:

(a) on or after 8 July 2015;
(b) downsized from a "high value residence" to a lower value one; or
(c) disposed of their residence without owning another at death,

provided that other assets are "closely inherited".

These downsizing provisions came into force on 15 September 2016.

Elements of RNRB

The RNRB is an IHT nil rate band, with 3 main elements:

(a) the residential enhancement;
(b) the brought-forward allowance; and
(c) the downsizing addition.

Residential enhancement

The residential enhancement is available where:

(a) a person (called P in the legislation) dies on or after 6 April 2017; and
(b) P's estate immediately before death included a qualifying residential interest ("QRI");
(c) the QRI is "closely inherited" i.e. by lineal descendants (children and grandchildren etc) their spouses or civil partners at P's death, and their surviving spouses or civil partners who have not "remarried" at P's death (collectively "direct descendants", not that this is a phrase used in the legislation).

Qualifying residential interest (QRI)

A residential interest, in relation to P, means (IHTA 1984, s. 8H(2)):

(a) an interest in a dwelling-house;
(b) which has been P's residence;
(c) at a time when P's estate included that, or any other, interest in the dwelling house.

The general rule is that P's estate immediately before death must include such an interest. There can, however, only be one such residential interest. Where, therefore, P owned 2 or more interests, the personal representatives must nominate which interest is to be the "qualifying" residential interest.

It is not a requirement that P resided in the dwelling-house immediately before death, so long as P owned a QRI immediately before death and had formerly resided in the property in which P has a QRI. It would, therefore, be sufficient if P moved into a nursing home, and let their former residence, retaining the freehold.

Maximum residential enhancement

The maximum residential enhancement (IHTA 1984, s. 8D(5)(a)) is:

(a) 2017/18: £100,000
(b) 2018/19: £125,000
(c) 2019/20: £150,000
(d) 2020-26: £175,000.

Brought-forward allowance

In addition, the amount of the RNRB of P can be increased, by as much as 100%, if the brought-forward allowance applies, which will be the case if and to the extent that the residential enhancement of a predeceasing spouse or civil partner (R) was not used on the death of R.

That part of the RNRB, not used on R's death, can be brought-forward, to be utilised on P's death. The brought-forward allowance operates in much the same way as the TNRB.

The RNRB may have been 100% unused on R's death, because:
(a) R did not own a QRI on death; or
(b) R owned a QRI on death, but it was not closely inherited, e.g. because it was left to R's surviving spouse or civil partner, or to a NRB discretionary trust; or
(c) R died before 6 April 2017 when the RNRB first became available.

Alternatively, a percentage (less than 100%) may have been unused, e.g. if the value of the QRI which was closely inherited was less than the RNRB on R's death.

Where, therefore, on the death of R after 6 April 2017, R gave a QRI to a NRB discretionary trust, the brought-forward allowance will be available on the death of P.

Maximum RNRB

It follows that the maximum NRB on a death of a surviving spouse or civil partner from 2020 to 2026 is £1m:

(a) NRB: £325,000
(b) TNRB: £325,000
(c) RNRB (residential enhancement): £175,000
(d) RNRB (brought-forward allowance): £175,000

Total: £1m.

The RNRB, therefore, gives rise to a maximum IHT saving of 40% of £350,000, i.e. £140,000, or £70,000 in the case of a person who is not married, nor in a civil partnership. The total of all the nil rate bands, in the case of a married couple, can be as much as £1m, giving rise to a potential saving of £400,000.

The RNRB only applies to transfers on death. It does not apply to lifetime transfers, such as failed PETs. It is, however, not reduced by the value of chargeable transfers made within 7 years before death.

Tapering

P's "default allowance", i.e. the aggregate of their residential enhancement and brought-forward allowance, tapers if P's estate exceeds £2m.

For every £2 that the estate exceeds £2m, there is a reduction of £1.

P dies in 2020-21 with default allowance of £350,000 (P being entitled to a brought-forward allowance) and an estate of £2.1m.
The default allowance of £350,000 is reduced by 50% x (£2.1m - £2m), i.e. by £50,000, to £300,000.

The RNRB would be reduced to nil if P's estate equals or exceeds £2.7m (or £2.35m if P was not entitled to a brought-forward allowance).

The brought-forward allowance will also taper if the value of the estate of P's predeceasing spouse or civil partner (R) exceeded £2m. The brought-forward allowance is reduced by 50% of the amount by which R's estate exceeded £2m.

Closely inherited

In the case of a Will, the RNRB will only be available where P makes a disposition of a QRI which formed part of P's estate immediately before PPs death, to direct descendant(s):

(a) absolutely;
(b) on IPDI trusts;
(c) on a disabled person's trust;
(d) on a BMT or 18-25 trust (for P's child at 18, or at 18-25).

Not closely inherited

The RNRB will not be available in respect of a gift of a QRI to:

(a) a discretionary trust, unless there is an appointment to direct descendants absolutely, or on IPDI or BMT or 18-25 trusts, or on a disabled person's trust, within 2 years of death by virtue of IHTA 1984, s. 144);
(b) someone who is not a direct descendant, such as a spouse, sibling, cousin, partner etc;
(c) a trust for a child at 30, where the child is under 30 on P's death (since this will not be a BMT or 18-25 trust); or
(d) a trust for P's grandchild contingently on attaining any age, such as 18, if the grandchild has not attained that age on P's death (since a trust for a grandchild cannot be a BMT or 18-25 trust).

Nor will the RNRB be available in respect of a gift of an asset which is not a QRI, e.g. a legacy of a cash sum. That is the case even though the personal representatives appropriate a QRI in satisfaction of the legacy.

RNRB limited to value which is closely inherited

Where the value of the QRI which is closely inherited is less than the maximum RNRB, the residential nil rate amount ("RNRA") will be limited to that value.

Max. RNRB: £350,000
Estate: QRI worth £200,000, or share of QRI passing to direct descendant only worth £200,000

Subject to downsizing relief the RNRA cannot exceed £200,000. It is, therefore, important (subject to downsizing relief) to ensure that P's estate includes a QRI worth at least £350,000 and that it is closely inherited.

Downsizing addition

Downsizing relief is designed to ensure that the RNRB is not lost as a result of P "downsizing". P must have owned a qualifying former residential interest ("QFRI") and disposed of that interest on or after 8 July 2015 with the result that either:

(a) P's estate on death does not include a QRI; or
(b) P's estate includes a QRI which does not qualify in full for the RNRB on death (since it is worth less than the RNRB without downsizing relief) and which is of lower value on death than the QFRI on disposal.

The purpose of downsizing relief is to put P's estate back into the position it would have been in if P's estate continued to include the QFRI, or a QRI of the same value. There are complicated provisions designed to compensate P's estate by the "lost relievable amount".

However, there is an important limitation. The amount of the relief is limited to the value of the closely-inherited chargeable estate.

If, for instance, P's estate does not include a QRI, but downsizing relief is potentially available, P's Will should include a chargeable transfer of other assets or of cash to direct descendants, absolutely or on IPDI/disabled/BMT/18-25 trusts, of sufficient value to claim the RNRB in full. A gift of cash to direct descendants can qualify.

RNRB gift

Where P's estate includes a QRI and/or is entitled to downsizing relief, and is worth less than £2 million or not much more, P's Will could include a gift intended to take advantage of the RNRB to the maximum extent, i.e. a gift of:

(a) the whole or such share of any QRI of P as would entitle the estate to the maximum benefit of the RNRB; plus in order to make use of any downsizing addition:
(b) a pecuniary legacy of such amount (if any) as is necessary to ensure that the estate obtains such maximum benefit if and to the extent that the value of the QRI is insufficient for that purpose;

with a direction to the executors to make such claims and nominations to ensure that the estate obtains the maximum benefit of the RNRB such as:

(a) a claim to the brought-forward allowance;
(b) a claim to the downsizing addition; and
(c) where the testator had a QRI or QFRI in more than one dwelling-house, a nomination of one of those dwelling-houses.

The gift will, therefore, be of P's QRI and a pecuniary legacy sufficient to utilise the testator's RNRB in full, including any downsizing addition and brought-forward allowance.

Gift of QRI to direct descendants

The gift of the QRI or downsizing addition should be to direct descendants in such a way that the gifted property is closely inherited. A gift to the deceased's children or grandchildren absolutely, or on IPDI trusts, would qualify.

Beware of gifts to grandchildren on attaining a specified age, e.g. 18 or 25. Grandchildren will not "closely inherit" if their entitlement to capital is at 18 or 25 and they have not attained that age on the date of death. This is of particular relevance to substitutionary gifts for grandchildren in the event that a child does not attain a specified age. The grandchildren, taking in substitution for their parent, would need to be absolutely entitled on the death of the testator if the RNRB is to be available.

Gift to surviving spouse

A testator, who is married or in a civil partnership (T), should generally be advised to leave their estate (including their home) to their surviving spouse or civil partner, either absolutely or on IPDI trusts, rather than making a RNRB gift to direct descendants.

The transfer on the first death will be exempt. No use will have been made of the RNRB, with the result that the brought-forward allowance will be available on the second death.

The surviving spouse or civil partner (S) would also be more secure if an interest in the home is not given to their children or stepchildren.

It is also important to ensure that S has a QRI of sufficient value to claim the RNRB in full. This may not be the case if T leaves their share in the matrimonial home to direct descendants, rather than to S.

RNRB gift to direct descendants on first death

There are occasions when a RNRB gift might be considered.

P is entitled to brought-forward allowance from 1st marriage or civil partnership S1.

The brought-forward allowance from S1 will be wasted if P leaves their QRI to P's 2nd spouse or civil partner (S2). S2's estate cannot claim the benefit of the brought-forward allowance to which P's estate was entitled following S1's death, since S2 was not married to or in a civil partnership with S1 (IHTA 1984, s. 8G(2)).

P should make a RNRB gift, equal to the value of the brought-forward allowance, to direct descendants, if P predeceases S2.

P's spouse or civil partner (S) is entitled to brought-forward allowance from S's 1st marriage or civil partnership

If P leaves a QRI to S, S will only be entitled to one brought-forward allowance. S's estate cannot claim two allowances from two deceased spouses/civil partners (IHTA 1984, s. 8G(3)(d)).

P should make a RNRB gift, equal to the value of the RNRB, to direct descendants.

P has a stepchild by a previous marriage, and neither P, nor P's current spouse or civil partner (S), have any children.

P could leave a QRI, equal to the value of the RNRB, on IPDI trusts for the stepchild, which can be terminated in favour of S by way of a PET. The RNRB applies where a QRI is settled on IPDI trusts for a direct descendant, even if the IPDI is terminated shortly after death.

P is entitled to the downsizing addition following the sale of P's former home before P's death. P and their spouse or civil partner (S) move into rented accommodation. S did not own an interest in P's former home and has no QRI on death.

On S's death S's estate will not be entitled to P's downsizing addition as S had no interest in P's former home. P should give the downsizing addition to their direct descendants absolutely or on IPDI trusts.

Avoidance of tapering in estate of surviving spouse

A RNRB gift on the death of P might also be considered where the estate of P's surviving spouse or civil partner (S) would exceed the taper threshold (currently £2m) if S were left the matrimonial home.

P's estate: £1.5m.
S's estate: £1m.

If P left everything to S, S's estate would, prima facie, be entitled to the residential enhancement and the brought-forward allowance (say £350,000). However, S's estate might then be worth at least £2.5m (perhaps £2.7m by S's death) with the result that the RNRB would taper, potentially to nil.

This might be avoided, or mitigated, if P makes:

(a) a NRB gift to a discretionary trust: £325,000; and
(b) a gift to direct descendants of a QRI, limited to the value of the RNRB: £175,000.

Total: £500,000

These gifts would reduce S's estate by £500,000 as at P's death which (depending on the value of S's estate) might mean that S's estate on death would not exceed £2m, in which case tapering will not apply.

P's estate would then be entitled to the RNRB (the residential enhancement). S's estate would, as a result of the NRB gifts by P, also be entitled to claim the RNRB (the residential enhancement, but not the brought-forward allowance as the RNRB has been utilised on P’s death).

High-value estate of surviving spouse

The estate of the surviving spouse or civil partner (S) may exceed the taper threshold by a considerable margin, in which event it may be sensible for the predeceasing spouse/civil partner (P) to make a RNRB gift to direct descendants.

P’s estate: £1.5m.
S’s estate: £4m (£5.5m following P’s death).

If P left the whole of their estate, including P’s interest in the matrimonial home, to S, the RNRB would not be available on P’s death. On S’s death, the RNRB (the residential enhancement and the brought-forward allowance) would also not be available, due to tapering. The RNRB would not, therefore, be available at all, in either estate.

P’s residential enhancement should ideally be used on P’s death, as P’s estate is worth less than £2m, by P leaving a share in the matrimonial home, equal to the value of the RNRB, to P’s children absolutely or on IPDI trusts.

Option to spouse to purchase QRI

S might, however, be uncomfortable if a share in the matrimonial home is left to P’s children.

P might, therefore, make a specific gift of a QRI, equal to the value of the RNRB, to the children absolutely, or on IPDI trusts, but subject to an option exercisable by S within, say, 1 year of death, to purchase the QRI at market value.

As the RNRB focuses on the position at death, the RNRB will be available on P’s death, and S will have full security as S will, following the sale, become the sole beneficial owner of the matrimonial home. The children will end up with cash.

S would need to have the funds to buy the QRI and SDLT may apply. CGT should be minimal.

Demonstrative legacy

P might consider leaving a demonstrative legacy equal to the value of the RNRB, payable primarily out of P’s interest in the home, to direct descendants. This should qualify as a gift of a QRI. The legacy can be settled out of other assets.

Second home

P may have owned immediately before death a second home, or an interest therein, of a value equal or greater than the RNRB. Provided that P resided there at a time when P had an interest therein, P’s interest therein would be a residential interest. P’s personal representatives could nominate the second home as the relevant dwelling-house, with the result that P’s interest therein would be a QRI (IHTA 1984, s. 8H(4)). If, therefore, P left their interest in the second home to direct descendants, in such a way that it is closely inherited, the RNRB would be available. S can continue to own 100% of the matrimonial home.

RNRB gift to discretionary trust

A RNRB gift to a discretionary trust will not qualify for the RNRB since the trust assets will not be closely inherited. However, a RNRB gift to a discretionary trust has much to recommend it, if P is survived by S.

Typically, P and S own their home in equal shares. P leaves part of their half share, equal to the value of the RNRB, to the discretionary trust, and the remainder of that share to S absolutely or on IPDI trusts. S retains their half share in their own right.

This gives the option for the trustees to appoint P’s QRI within 2 years of death to:

(a) direct descendants absolutely or on IPDI trusts (making use of the RNRB); or
(b) S absolutely or on IPDI trusts (making use of the spouse exemption).

The appointment will be retrospective to P’s death for IHT purposes by virtue of IHTA 1984, s. 144 which applies to appointments made within 2 years of death. The trustees could be required to exercise their discretion within 23 months of death with a direction, say, that S should be entitled in default if alive, and if S has died, to the children absolutely.

Appointment to spouse

An appointment to S might be appropriate if, say, P's estate is above the taper threshold (so that the RNRB is not an issue) or if the trustees determine that the IHT benefits of the RNRB are less important than S having full control and ownership of the house. P could give guidance to the trustees in a letter of wishes.

Appointment to children

An appointment to direct descendants within 2 years of P's death might be appropriate if:

(a) S has died within the 2-year period; or
(b) the appointment is on IPDI trusts for the direct descendants, rather than absolutely, and S is one of the trustees.

Guidance to trustees

It would be advisable for P to leave a letter of wishes giving guidance to the trustees. It could express the wish that:

(a) If the value of S's estate, including any assets inherited from P, is above the taper threshold, then the trustees should consider and, if necessary, take, tax advice as to whether it would be efficient, from an IHT perspective, to use the RNRB on P's death, rather than on S's.
(b) The trustees should have regard to the financial interests of S and of P's direct descendants such as their children and grandchildren.
(c) In the case of conflict between the interests of S and the direct descendants, the interests of S should take precedence, alternatively the interests of the direct descendants (but not, perhaps, grandchildren) should take precedence.

The Will itself could contain provisions exonerating the trustees from any liability if they take either course; in particular if they determine not to appoint to direct descendants despite the loss of the RNRB.

The identity of the trustees is an issue. If P's main concern is to protect S, S could be appointed as a trustee, perhaps with an independent third party, with a provision that the trustees can exercise their powers to benefit S if there is an independent trustee.

Interaction of RNRB gift with standard NRB legacy

P could combine a NRB legacy to a discretionary trust with a gift of the whole of P's QRI, or such part of their QRI as is limited to the amount of the RNRB, either to:

(a) direct descendants absolutely, or on IPDI, disabled, BMT or 18-25 trusts; or
(b) to the trustees of the NRB discretionary trust (in addition to the NRB legacy).

If option (a) is adopted, the RNRB will apply to the gift of P's share in the residence up to the maximum amount of the RNRB.

If, however, option (b) is adopted, there will be an up-front liability in respect of the IHT payable on P's death. P's QRI, being given to a discretionary trust, will not be closely inherited. However, the trustees could make use of IHTA 1984,s. 144 by appointing the QRI within 2 years of death to direct descendants (making use of the RNRB) or to P's surviving spouse or civil partner (making use of spouse exemption). The IHT attributable to the original gift to the discretionary trustees in excess of the NRB would then have to be reclaimed following the appointment.

Avoidance of up-front liability

An up-front IHT liability can be avoided if there is a legacy to the discretionary trustees of the maximum amount which can be given without incurring any liability to IHT, with no specific gift of a QRI to the NRB trust.

The NRB legacy cannot, at the outset, exceed the NRB (including any TNRB) since a gift of cash to a discretionary trust does not qualify for the RNRB. Therefore, no IHT will be paid up-front on the death of P.
However, the executors could within 2 years of death:

(a) appropriate such part of P's share in the matrimonial home, equal to the value of the RNRB, to the NRB trust in satisfaction of the NRB legacy; and
(b) in their capacity as trustees appoint that share within 2 years of death, to the children, or to the surviving spouse or civil partner (S) absolutely or on IPDI trusts.

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If the trustees appoint to the children absolutely or on IPDI trusts, within 2 years of death, the RNRB can be claimed. If they appoint to S, the spouse exemption will apply.

Either way, as a result of the appointment, it will then be possible for the executors to transfer, free of IHT, cash or other assets equal to the full amount of the NRB legacy (say, £325,000) to the NRB trust without any IHT becoming payable.

Life interest for surviving spouse or civil partner

P may settle their share in the matrimonial home, on IPDI trusts for P's surviving spouse or civil partner (S), with remainder to S's children or stepchildren.

The RNRB will only be available on the death of S, in respect of the trust's share in the matrimonial home, if the children become "beneficially", i.e. absolutely, entitled on the death of S (IHTA 1984, s. 8J(5)). This means that, in respect of the trust's share in the matrimonial home:

(a) the gift over to the children (and any substitutionary gifts to grandchildren) should not be contingent, e.g. on attaining a specified age; and
(b) there should be no overriding powers of appointment exercisable after the death of S.

S may have, in their own right, a share in the matrimonial home of sufficient value to make full or part use of the RNRB. It may, in those circumstances, be better to provide that the RNRB gift should come, in priority, out of S's estate, and that the gift of P's share should be by way of top-up, if the gift from S's free estate is insufficient to use the RNRB in full. The RNRB gift, out of the settled estate, would then be limited to such share of the residence as is necessary to ensure that the trust fund obtains the maximum benefit of the RNRB on the death of S. Otherwise, age-contingencies/overriding powers can continue to apply to the remainder of the trust fund settled upon S for life.

DEEDS OF VARIATION

Statutory requirements

IHTA 1984, s. 142(1) provides that where within the period of 2 years after a person's death any of the dispositions (whether effected by will, under the law relating to intestacy or otherwise) of the property comprised in the estate immediately before their death are varied, by an instrument in writing made by the persons or any of the persons who benefit or would benefit under the dispositions, the Act applies as if the variation had been effected by the deceased.

This applies for all the purposes of IHT. An election must, however, be made that s. 142(1) is intended to apply to apply. The variation must not be for extraneous consideration, i.e. for any consideration in money or money's worth other than consideration consisting of the making, in respect of another of the dispositions, of a variation or disclaimer to which IHTA 1984, s. 142(1) applies (IHTA 1984, s. 142(3)).

A variation will also be effective to avoid a chargeable disposal by the beneficiary for CGT purposes if an appropriate election is made that TCGA 1992, s. 62(6) applies. However, the effect is more limited. The beneficiary will, for instance, be treated as the settlor for CGT purposes.

It is common, therefore, for a beneficiary under a will or an intestacy to execute a Deed of Variation within 2 years of death so as to benefit others where the retrospective tax effect of the Deed of Variation would be advantageous. There will be no transfer of value by the beneficiary, and no gift with a reservation of benefit.

Variation by spouse to NRB trust

A spouse or civil partner (S) surviving T might wish to redirect a sum equal to a single NRB to a discretionary trust of which they are a beneficiary. This might be advantageous where S is entitled to a TNRB from another previous marriage, and the TNRB from T would otherwise be lost. A NRB trust may also be preferable where the value of the trust assets is likely to increase in value substantially (see **Increased value of NRB trust assets greater than TNRB** under **NIL RATE BAND GIFTS** above).

There will be no gift with a reservation of benefit by S even though S can benefit under the trust. S will, however, be the settlor for income tax purposes.

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Business/agricultural property

If T has left property qualifying for BPR and/or APR to S, S might redirect such property to their children.

The purpose would be to ensure that relief is not wasted should BPR or APR not be available on the death of S (see **Gift to chargeable beneficiaries** under **BUSINESS AND AGRICUTURAL PROPERTY** above).

Variation of gift of residue and the RNRB

T may leave their residuary estate, including their residence, in part to their children or grandchildren, and in part to others. The RNRB may still apply even though there is not a specific gift of the testator's QRI to direct descendants.

IHTA 1984, s. 8E(1) provides, in effect, that the value of a QRI which is closely inherited is equal to the percentage share of the value transferred on death which is attributable to the QRI.

T has a residuary estate worth £300,000
T gives 2/3 share of residue to T's children: £200,000
T gives 1/3 share of residue to partner: £100,000
T's residence is worth £200,000.
RNRB on death in 2020/21: £175,000.

The RNRB will be limited to 2/3 of the value of T's residence (2/3 x £200,000 = £133,333). This is less than the maximum amount of the RNRB of £175,000 with the result that the RNRB will not be available in full.

That will be the case even if the executors appropriate T's residence, worth £200,000, to the children since that involves the exercise of an administrative power by them, rather than a disposition by the deceased (IHTM46033).

The children and the partner could, however, execute a Deed of Variation within 2 years of the death of T varying the disposition of the residuary estate as if the Will had provided that the children be entitled to the residence in or towards satisfaction of their entitlement to a 2/3 share of the residuary estate. The children would be entitled to a share of T's residence, worth £200,000, and the RNRB would be available in full.

Variations in favour of charities

Chargeable beneficiaries might be advised to redirect part of their entitlement to charities, so as to take advantage of the reduced rate of IHT of 36% if at least 10% of the estate is left to charity (see **Charitable gifts: reduced rate** above).

Short-term IPDI to surviving spouse

A beneficiary might execute a Deed of Variation settling the beneficiary's entitlement on short-term IPDI trusts for the testator's (T's) surviving spouse or civil partner (S), which terminates automatically in favour of the beneficiary after a fixed period.

The redirection to S will qualify for the spouse exemption. No IHT will be payable on T's death, so long as S's IPDI terminates more than 2 years after the death of the testator (IHTA 1984, s. 142(4)). The variation on IPDI trusts must, therefore, take place within the 2-year period after death, but the termination of the IPDI must take place thereafter. The IPDI trusts should, ideally, last for a period of some months so that they have some duration. The IPDI trusts would then have some independent reality in that the IPDI beneficiary would be taxed on the income, and IHT would be payable on their death while retaining an IPDI.

What should be avoided is a variation of the disposition of property by the beneficiary to S absolutely on the understanding that S will transfer the property back to the beneficiary. This will be a variation for extraneous consideration within IHTA 1984, s. 142(3). The variation will not be effective for IHT purposes, and the spouse exemption will be lost.

IPDI for child: skipping a generation

A child of the deceased, with sufficient funds of their own, might redirect benefits to their children (grandchildren of the deceased), absolutely or on flexible IPDI trusts, thereby skipping a generation (see **Generation skipping** under **WILL TRUSTS** above). The variation will avoid a PET or chargeable transfer by the child.

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