

The Exempt Asset Trust bolt on

Private client solutions for the St. James's Place Partnership

What is the Exempt Assets trust bolt on and who is it for?

The Exempt Asset trust bolt on is an additional provision in the Wills of a married couple, or couple in a registered civil partnership, who own a business or other inheritance tax (IHT) favoured assets such as agricultural land. The additional provisions create a discretionary trust on the first death to which the exempt assets are given.

How does the Exempt Asset trust bolt on work?

Inheritance tax (IHT) is payable on all assets exceeding £325,000 in value for an individual or £650,000 for a couple (2015/16). In addition the Residence Nil Rate Band (RNRB) may exempt from April 2017 an additional portion of certain estates. When this is fully in force in 2020/21 the RNRB will exempt a further £350,000 of a couple's joint estate if they have ever owned a property and leave the property, or assets representing it, to "lineal descendants" (broadly children, grandchildren and their spouses and civil partners). In addition, certain categories of assets, namely business and agricultural property, benefit from generous IHT reliefs that can reduce the taxable value of these assets to nil.

When exempt assets are owned by a married couple or couple in a registered civil partnership careful thought should be given to Will drafting to maximise the benefit of these reliefs. If, for example, exempt assets are left to a surviving spouse then the full benefits of the reliefs can be lost as no tax is payable in any case due to the surviving spouse exemption.

Instead of leaving your exempt assets in your Will to your spouse outright or to a life interest trust for his or her benefit you should consider using the Exempt Asset trust bolt on and leaving these assets to a discretionary trust of which your spouse, children, grandchildren and any other persons chosen by you would be the beneficiaries. This gift will be free of IHT due to Business Property Relief (BPR) or Agricultural Property Relief (APR) and the benefit of the reliefs is crystallised. By comparison if the assets

pass to the surviving spouse a change in circumstances or law might mean that the reliefs are no longer available on his or her death.

The assets in the trust are outside of the survivor's estate for IHT purposes. To maximise tax efficiency, the surviving spouse could consider buying the exempt assets from the discretionary trustees. The result of the purchase will be that the discretionary trust has cash in it whilst the spouse owns the exempt assets. If all the necessary conditions are met the surviving spouse should then be able to claim BPR/APR again on the second death. This can potentially save IHT and double the benefit of BPR/APR.

What is the IHT position?

As mentioned above there will be no IHT on the first death due to the availability of spouse exemption and APR/BPR. The tax efficiency of the Exempt Asset trust bolt on is maximised if the surviving spouse is able to buy the exempt assets from the trust. The case study below illustrates how this results in a significant IHT saving.

In addition, the Exempt Asset trust bolt on can help to maximise the benefit of the RNRB. The RNRB is reduced by £1 for every £2 an individual's taxable estate (ignoring reliefs such as business relief) exceeds £2 million. If an Exempt Asset bolt on is used on the first death this can reduce the surviving partner's estate and increase entitlement to the RNRB. For example, if a couple have a joint estate of £2.7 million, including business property of £400,000, no RNRB would be available to the couple. Placing the shares and £300,000 of cash into a discretionary trust on the first death would mean that no IHT is payable on the first death, and the assets of the surviving spouse would be reduced to £2m, meaning that their estate could qualify for the RNRB, leading to an additional £140,000 IHT saving.

Does the Exempt Asset trust bolt on protect my assets?

The capital in the trust is protected in several ways. The beneficiaries can only receive capital at the trustees' discretion, enabling the trustees to control the situation and to avoid capital being used in a way that you would not want.

In addition, the capital and income is protected from claims by third parties, in so far as is possible, such as creditors and estranged spouses. Discretionary trusts also have long-term IHT mitigation benefits.

Case study

John is married to Linda. John owns the majority shareholding in the family company, Smith Trading Limited, which has a market value of £325,000. As Smith Trading Limited is a trading business the shares qualify for BPR at a rate of 100%, meaning that the shareholding is valued at £0 for IHT purposes. Minority shareholdings are owned by John and Linda's children, Sam and Denise, who also work in the business. There is no shareholders' agreement in place.

John's assets, excluding the business, amount to £400,000 and Linda's assets to £450,000. If they simply leave all their estate to the other spouse (whether as an absolute gift or in an immediate post-death interest trust) then the total IHT bill payable if they both die by 2016 will be £210,000 (assuming that the shares have been sold by the second death).

Tax efficient solution using the Exempt Asset trust bolt on

Scenario 1

John's Will leaves his shares in Smith Trading Limited into a Discretionary Trust, from which his family can benefit following his death, with the rest of his estate amounting to £400,000 passing outright to Linda. John puts in place a shareholders' agreement containing "cross-options" which allows Linda, as John's spouse, to purchase John's shares from the Discretionary Trust, should she so choose.

When John dies, his shares in Smith Trading Limited qualify for BPR and so pass into the Discretionary Trust free of IHT at a value of £0. Linda then exercises the cross-options granted in the shareholders' agreement to purchase the shares from the trust for their market value of £325,000.

Linda sells the shares during her lifetime for £325,000. The cash is added to her non-business estate giving her a total estate of £850,000. Assuming a tax free nil rate band of £325,000, this means the tax payable following Linda's death in 2016 is reduced by £130,000 (from £210,000 to £80,000) due to the reduction in Linda's estate of £325,000 (the purchase price paid by her to the trust for the shares.) The cash in the trust can remain invested for the benefit of the couple's children and grandchildren.

Scenario 2

Alternatively, if Linda dies owning the shares (and if she survives the purchase of the shares by two years) she would own BPR qualifying shares of £325,000 (valued at £0 for IHT purposes). Accordingly, she would have non-business assets of £525,000 and shares valued at £0, meaning a taxable estate of £525,000 on which no tax is due. The total IHT bill on the estate is reduced from £210,000 to nil.

Scenario 3

Smith Trading has two other shareholders: Sam and Denise. Again, a shareholders' agreement incorporating cross-options is in place. As before John leaves his shares in the company to a discretionary will trust. Sam exercises the cross-option to buy John's shares from the trust.

Linda has assets of £850,000 following John's death and, after Sam's purchase, the trust holds cash of £325,000. On Linda's death the IHT payable is £80,000 ($£850,000 - £650,000 = £200,000 \times 40\% = £80,000$.) As with Scenario 1 there is a £130,000 reduction because of John's gift of the shares to the discretionary will trust.

It is also possible to capture the BPR even after a sale of the shares by reinvesting cash into other assets qualifying for BPR. It is recommended that any shareholders' agreement is reviewed to ensure that the surviving spouse is entitled to buy the shares from the trustees of the discretionary trust.

What will we provide you with?

- Wills for each of a couple incorporating your chosen trusts (for example, Asset Protection, Next Generation or Family Protection Wills)
- The Exempt Asset trust bolt on
- Letters of Wishes

The cost

£500 plus VAT for a single Will or £700 plus VAT for mirror Wills when added to the following Wills packages: Asset Protection Wills (from £1,750 plus VAT), Next Generation Protection Wills (from £2,250 plus VAT) or Family Protection Wills (from £2,500 plus VAT).

For further information please contact:

Bristol

Anthony Fairweather 0345 209 1265
anthony.fairweather@clarkewillmott.com

Bristol and Cardiff

Jane Halton 0345 209 1417
jane.halton@clarkewillmott.com

Bristol and London

Carol Cummins 0345 209 1275
carol.cummins@clarkewillmott.com

Liz Smithers 0345 209 1115
elizabeth.smithers@clarkewillmott.com

Manchester and Birmingham
Paul Davies 0345 209 1783
paul.davies@clarkewillmott.com

Southampton

Emma Pope 0345 209 1823
emma.pope@clarkewillmott.com

Taunton

Tom Chiffers 0345 209 1693
tom.chiffers@clarkewillmott.com

Disclaimer: This briefing is intended to highlight issues only for the purposes of general interest and is not intended to be a comprehensive statement of the law. Although we have taken care over the information, you should not rely on it as legal advice. We do not accept any liability to anyone who does rely on its content. Last updated: July 2017. Ref: 12958919-4

Great service... Great people...

clarkewillmott.com