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Property Discount (Wills) bolt on

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

What is the Property Discount bolt on and who is it for?

The Property Discount bolt on comprises additional provisions in Wills for each of a married couple, or couple in a registered civil partnership, whose combined estates are liable to inheritance tax (IHT). The additional provisions incorporate a discretionary trust into the Wills, which comes into effect on the death of the first of the couple. A share in the family home, or in other property, is appropriated to the trust following the first death so that the property will then be jointly owned by the trustees and the surviving partner.

How does the Property Discount bolt on work?

It is an established valuation principle accepted by HMRC that a share of property held in joint names (other than with a spouse or registered civil partner) should have a discount applied to its value to reflect the difficulties of realising a part share in a property.

For example, George owns a cottage jointly with his sister. They each own a half share and the cottage is worth £400,000. The usual discount applied to a part share is 10-15%. This means that for IHT purposes George's share is worth between £170,000 and £180,000, rather than the £200,000 that might be expected.

Property Discount bolt on uses this valuation discount by incorporating a discretionary trust on the first death of a couple into their respective Wills into which a share of the couple's property can be given. This can be a share of the family home and/or any buy-to-let or investment property owned by the couple. This means that ongoing ownership of the property after the first death is divided between the discretionary trust and the surviving spouse. On the surviving spouse's death the value of his or her share of the property is therefore discounted by 10-15% to reflect this joint ownership.

The maximum value that can be transferred free of inheritance tax into the trust on the first death is at present £325,000 (assuming no gifts in the seven years preceding the first death).

The trust ensures that the surviving spouse retains a measure of control through the trustees and, if necessary, his or her continued occupation of the property can be protected. Unlike a lifetime gift of a share in a property there is no necessity to pay a full market rental for the survivor's continued occupation of the family home.

What is the IHT position?

This is best illustrated by an example. Sarah and Michael own a property valued at £850,000 (and other assets of £500,000). If they simply leave their entire estate to the surviving spouse on the first death, on the survivor's death there will be IHT to pay of £280,000 (at present rates). If the survivor dies after the new main residence IHT nil rate band is fully in force in 2020/21 then they may be entitled to an additional IHT allowance of £350,000 relating to their main residence which will reduce the IHT bill to £140,000, still a substantial amount.

If Sarah and Michael incorporate the Property Discount bolt on into their Wills, and leave 10% of the property to a Discretionary Will trust on the first death, the IHT payable on the second death will be calculated on the value of the retained share in the property less a discount.

The retained share in the property is worth £765,000 (£850,000 – 10% given to the trust) which, with a discount of 15%, gives a value of £650,250. The survivor's nil rate band of £325,000 can be deducted in calculating the chargeable estate. The nil rate band of the first to die will be reduced by the gift to the discretionary trust. In this example, 73.84615% of the nil rate band of the first to die (£240,000) will be available making the chargeable estate £585,250 and the IHT due £234,100, a tax saving of £45,900. The overall tax saving would be the same if the estate was entitled to the new residence IHT nil rate band.

	IHT position without the Property Discount bolt on £	Assets and reliefs with the Property Discount bolt on £	IHT position with the Property Discount bolt on £
House	850,000	House (-10% to trust and 15% valuation discount)	650,250
Other assets	500,000	Other assets	500,000
Total estate	1,350,000	Total estate	1,150,250
Less nil rate band x 2	-650,000	Less nil rate band x 1 and 73.84615% of nil rate band of first to die	-(325,000+ 240,000)=- 585,250
Chargeable estate	700,000	Chargeable estate	585,250
IHT payable @ 40%	280,000	IHT payable @ 40%	234,100
		IHT reduction	**45,900**

If the property is sold there may be some capital gains tax (CGT) on the difference between the discounted value and the disposal cost but as the maximum rate of CGT is 28% this represents a tax saving overall and CGT may be mitigated by action and allowances available to the Trustees.

There is no requirement for anyone to survive for seven years. In addition, the share of the property in the trust, and any increase in its value between the first and second deaths, is outside of the survivor's estate. The Discretionary Will Trust is potentially liable to a maximum IHT charge of 6% every ten years or when capital is distributed from the trust but provided that the value of the property share in the trust remains below £325,000 in practice this tax charge will be nil.

How does this product interact with the residence nil rate band (RNRB)?

The RNRB, when fully in force in 2020/21, will exempt £350,000 of a married couple's assets from IHT provided on death they leave an interest in an home worth at least this amount, or assets of equivalent value if they have disposed of their home, to "lineal descendants" (broadly children, grandchildren and their spouses and civil partners). Assets in a discretionary trust (unless further action is taken) will not qualify for the RNRB. It is therefore good tax planning to ensure that, after deducting the value of the gift of a share in the house to the discretionary trust on the first death, the survivor is left with a property interest of sufficient value to take full advantage of the RNRB.

This product can be used to increase entitlement to the RNRB. For example, if a couple has a joint estate of £2.7 million (including a house valued at £1 million), because the RNRB is reduced by £1 for every £2 of an estate exceeding £2m, they will have no entitlement at all to the RNRB.

If, however, they leave a share in the property worth £300,000 to the discretionary trust on the first death, not only will the survivor's estate benefit from the property discount, but the taxable estate of the survivor will be reduced to £2,330,000 leading to entitlement to RNRB of £185,000, and an overall IHT reduction from £820,000 to £718,000, £74,000 of which is attributable to the enhanced RNRB entitlement.

Does the Property Discount bolt on protect my assets?

The capital in the trust is protected because your 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. Moreover, if your partner has to move into residential care then the share of the property in the trust will not be available to fund care fees (unless the trustees decide to exercise their discretion in this way).

What will we provide you with?

- Wills for each of a couple incorporating your chosen trusts (Asset Protection, Next Generation or Family Protection Wills)
- Letters of Wishes
- The Property Discount bolt on additional Will provisions.

The cost

£500 plus VAT for a single Will and £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).

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