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Sheffield Life and Pensions Legal Update

Probate – DIY or instruct a Solicitor?

1. The Residence Nil Rate Band
2. The Small Print
3. Pitfalls to watch out for
4. Examples
5. Looking at the fine print
6. Solution

Residence Nil Rate Band (RNRB)

The Residence Nil Rate Band (RNRB) was introduced in 2017. It has increased in the following increments: -

- 2017/18 £100,000
- 2018/19 £125,000
- 2019/20 £150,000
- 2020/21 £175,000

The RNRB can be transferred between married couples in the same way as the “normal” nil rate band.

The maximum nil rate band exemption for married couples is therefore: -

2 x £325,000
2 x £175,000
= £1,000,000

The RNRB for married couples could be an inheritance tax (IHT) saving of £140,000.

The Small Print

The deceased owns the ‘right’ type of interest in a residential property at death or can claim a downsizing addition. To be eligible for to claim the RNRB:-

Who can inherit?	The concept of “closely inherit”. The interest is gifted to children or remoter descendants. Broad definition of descendants to include stepchildren (by marriage), natural children who have been adopted out, foster children and the spouses and widows of such descendants if they have not remarried.
How?	Outright gift. Limited gifting into trust examples i.e., bereaved minors trust, disabled persons trust…
Limit on the size of the estate?	Estates £2,000,000 and below ok. Estates exceeding £2,000,000 hit the tapering threshold. We lose £1 of RNRB for every £2 over the limit. RNRB effectively tapers away to £0 at £2,700,000. ie if an estate is worth £2.5 mn the RNRB has tapered away to £100,000.
Tax planning opportunities?	Death-bed gifting. Tax planning on first death.

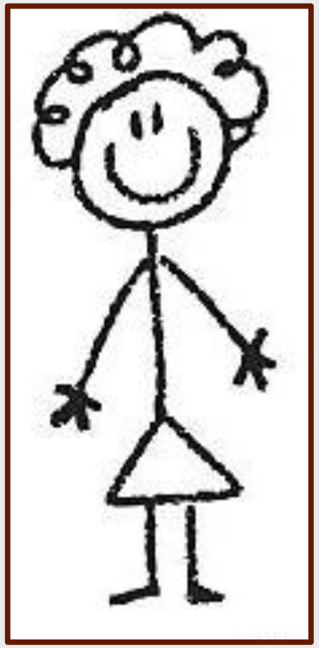
Pitfalls to watch out for

Lots of Wills were done pre-RNRB so they didn't have this IHT exemption in mind.

Many older Wills incorporate Nil Rate Band Discretionary Trusts and Life Interest Trusts. It is possible that the type of Will trust means estates will not automatically be eligible for the full RNRB, but steps can be taken.

Example 1 : Mildred

Mildred has inherited from her husband, who died a number of years ago. Mildred has struggled with her health recently and her sister has been a good support to her. Mildred has therefore put a Will in place that gifts 2/3 of her estate equally between her two children and the remaining 1/3 to her sister. The two children have decided they would like to administer their mum's estate themselves. The family home is worth £450,000 and Mildred had a stocks and shares ISA portfolio worth £500,000 and cash of £500,000.



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If no planning steps are taken HMRC will take the view that each of those three beneficiaries will inherit a 1/3 of the property. The two children will closely inherit but the sibling won’t. This means that only two thirds of the deceased’s interest in the property is closely inherited. The property is worth £450,000, only 2/3 of this (£300,000) is eligible for the RNRB. 2 x RNRBs can be claimed, but £50,000 of the RNRB is wasted, meaning £20,000 more IHT is due.

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If the children had gone to see a solicitor?

They would advise to do a Deed of Variation. The three agree that the property is to pass to the two children and there is a balancing exercise with other assets so overall the sister still receives an inheritance to the same value. This is to the benefit of all three of them in the sense that they all get the benefit of less IHT being paid.

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Example 2 – Geoff & Sheila

Geoff and Sheila are married with two children, Sue and Richard. The couple own the family home as tenants in common together, a small investment portfolio and several jointly held bank accounts.

The couple put wills in place in 2010 gifting half the family home into a life interest trust for the benefit of the survivor and on second death to gift everything equally between their two children.

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Geoff died in 2014 and after his death Richard started to have marriage difficulties. By 2016 Sheila was worried that if Richard inherited outright his inheritance could be factored into his divorce. To give an element of asset protection, Sheila updated her will to say her entire estate should pass into a discretionary trust. Sheila dies in 2021.

The problem - Neither Sue nor Richard closely inherit from Sheila. Unless something is done, her RNRB would be lost.

The solution - A Deed of Appointment whereby a share of the family home up to the value of the RNRB is appointed to Sue and Richard absolutely. This is done within two years of the date of Sheila's death, and it enables Sheila's executors to apply for the RNRBs.

Looking at the fine print – old Wills

There are some older Wills that were drafted to achieve maximum flexibility. Here's an example of a power of appointment clause from a 2007 Will and was frequently used in wills for the likes of Geoff and Sheila where there was a life interest trust for the benefit of the surviving spouse on first death, and gives us concern:

> "During the Trust Period (being for the purposes of this clause of this my Will the period ending on the earlier of the last day of the period of eighty years less one day from the date of my death which period and no other shall be the applicable perpetuity period and such date as my Trustees shall by deed at any time or time specify not being a date earlier than the date of execution of any such deed or later than a date previously specified) my Trustees (being at least two in number or a trust corporation) may at any time or times:

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By deed revocable or irrevocable appoint that all or any part of or parts of my Residuary Estate shall be held on such trusts (which may include discretionary or protective powers or trusts) - but without infringing the rule against perpetuities and excessive accumulations of income - in favour or for the benefit of all or any one or more of Sheila and Sue and Richard and any remoter issue through Sue and Richard but in each case who are alive at the start of or born during the Trust Period but not otherwise and such charity or charities as my Trustees may in their discretion decide to appoint and any such appointment may include such powers and provisions (including dispositive and administrative ones exercisable by my Trustees or any other person) and such other provisions as my Trustees in their discretion think fit whilst no exercise of the power contained within clause of this my Will shall invalidate any payment or application of all or any part of the capital or income of my Residuary Estate made under the trusts of this my Will or made under this or any other power conferred by this my Will or by law,”

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The idea at the time was to increase flexibility. However, this clause is now flawed in the sense that the overriding power of appointment does not automatically come to an end when the surviving spouse dies. This could “scupper” the RNRB. Although your client may be confident, they have Wills in place that are a good expression of their wishes, could they need updating?

The solution - if Geoff’s Will included this clause, then his trustees can take steps to amend the terms of Sheila’s life interest trust. We could release this power of appointment to make it clear that on Sheila’s death, that power of appointment comes to an end and the life interest trust assets pass automatically to Sue and Richard absolutely.

Example 3: Derek & Judith

They are a married couple. They own the family home together which is worth £900,000. Derek has a number of investments that are eligible for business property relief, totalling £1mn. Derek also has a bank account in his sole name with liquid assets of £200,000, Derek and Judith have a joint bank account together with £200,000. Judith has an account in her sole name and the current balance is £100,000. Derek dies in 2021. Under the terms of his Will, his entire estate passes to Judith. This means that Judith is financially secure but what about the RNRB?

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If Judith inherits everything from Derek (£1,650,000) then her estate at that time is £2,400,000. Judith does not have any underlining health conditions. Given the value of the family home, there is a very real risk that her estate will not be eligible for the RNRB as they have hit the taper relief threshold.

Note, although the investments are worth £1,000,000 maybe exempt from IHT, the value of them is taken into account when working out the value of the estates for RNRB purposes. Let's say for example Judith died in December 2022 and by this time the value of the family home had increased to £1,250,000.

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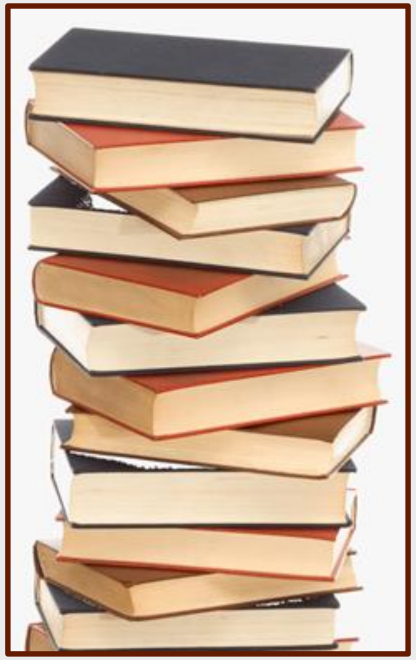
How does the IHT side of things stack up when Judith dies?

Family home	£1,250,000
Investments	£1,000,000
Liquid funds	£500,000
Total	£2,750,000
Less business property relief on the investments	(£1,000,000)
Less 2 x normal NRB	(£650,000)
IHT £1,100,000 at 40%	£440,000



A better outcome

On Derek's death, his estate is varied so he gifts the investment eligible for BPR equally between their two children, Joanne and Simon. On Judith's death, her estate is now worth £1,750,000 so the IHT is:-

Estate	£1,750,000
Less 2 x normal NRB	(£650,000)
Less 2 x RNRB	(£350,000)
£700,000 at 40% - IHT equals	£300,000

An inheritance tax saving of £140,000 has been made overall. We have also had the benefit of "crystalising" the business relief on the stocks and shares.

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This is perhaps a reminder of other steps that can be used after the death of the first of a married couple.

Could Judith have made gifts during her lifetime to reduce the size of her estate below that taper threshold of £2,000,000? If she had died within 7 years of making the gifts, although it would impact on the "normal" IHT position, it could gain access to the RNRB.

If the couple died within two years of each then a deed of variation is another option.

Example 4 : Unmarried partners, their separate children and the RNRB

What about a couple who are unmarried but have lived together for many years? If one of them has a child and they view that child as a "child of the family". Here is an example:-

Alex and Kate are an unmarried couple but have been together for 20 years. Kate has a daughter called Sophie. In his Will, Alex says that he would like his half of the family home to go to Kate. If Kate predeceases him then he would like his residuary estate to go to Sophie. He has always viewed Sophie as being equivalent to his daughter, so it felt like the right thing to do.

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Kate does die before Alex so Alex's estate passes to Sophie. Sophie does not qualify as Alex's stepchild for RNRB purposes. However, if no provision had been made for her then she would have been able to make a claim against Alex's estate because she is a "child of his family". This is one of the examples of the legislation not really joining up together.

Using this scenario, what if Kate had said in her Will that on her death, she wanted Alex to have a life interest or a right to occupy the family home but then gifted to Sophie on Alex's later death? Sophie is not Alex's child so when the capital of the trust fund comes to her this does not qualify as "closely inheriting", so there is no RNRB available. There is no transferrable RNRB either because Alex and Kate aren't married. It may be sensible from an IHT planning perspective for Kate to gift some of her share of the family home to Sophie to capture her RNRB. The will can be drafted so the gift is limited to the then value of the RNRB.

Example 5: Downsizing

These provisions apply to changes in the ownership of property from 8 July 2015 onwards.
To qualify, the former property would have had to qualify for the full RNRB and we are looking again at this notion of estates passing to descendants.

The starting point is the downsizing addition is usually the same as the RNRB that has been lost due to the move.

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If there is an estate where the family home was sold because the surviving parent had gone into care then don’t presume that the RNRB has been lost. Similarly, what if the former larger family home has been sold and the surviving parent had moved into a bungalow? Again, don’t presume the RNRB has been lost. There is, however, a complex calculation that sits behind these principals – too techy to go into today.

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Any questions?

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Sheffield Life and Pensions Legal Update

Topics

1. Making use of ISA Allowances on death

2. Proposed changes to the Nursing Home Fee cap and the impact on estate planning

3. Family Investment Companies – an alternative to traditional trusts

4. Changes to LPA guidance on Discretionary Management Funds

5. The importance of updating pre RNRB Wills

Making use of ISA allowances on death

- If your spouse or civil partner dies you can inherit their ISA allowance. As well as your normal ISA allowance you can add a tax-free amount up to either:

    - The value they held in their ISA when they died
    - The value of their ISA when it's closed

- This is a useful estate planning opportunity in the event that the deceased spouse places their sole assets into a life interest trust, the capital value of the ISA may not be available to the surviving spouse, but the ISA allowance can still be transferred and can be utilized if the surviving spouse has sufficient capital to do so.

- What are the time limits to use the APS?
    - An APS made as stock must be completed within 180 days of the distribution of the assets to the surviving spouse
    - An APS made as cash is available for three years after the date of death, or for up to 180 days after the administration of the estate is complete, whichever is later

What we can do

- Use a joined up approach between financial and legal advisors
- Include a gift/option within the Will of the ISA/the amount held in the ISA if required
- Look at rebalancing the estate if one spouse holds significantly more capital than the other

Proposed changes to nursing home fees

- On 7 September 2021, government set out its new plan for adult social care reform in England. This included a lifetime cap on the amount anyone in England will need to spend on their personal care, alongside a more generous means-test for local authority financial support.

- From October 2023, the government will introduce a new £86,000 cap on the amount anyone in England will need to spend on their personal care over their lifetime

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- In addition, the upper capital limit (UCL), the point at which people become eligible to receive some financial support from their local authority, will rise to £100,000 from the current £23,250.

- As a result, people with less than £100,000 of chargeable assets will never contribute more than 20% of these assets per year. The UCL of £100,000 will apply universally, irrespective of the circumstances or setting in which an individual receives care, making it a much more generous offer than a previous proposal in 2015. The lower capital limit (LCL), the threshold below which people will not have to pay anything for their care from their assets will increase to £20,000 from £14,250.

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Does this change the approach to estate planning?

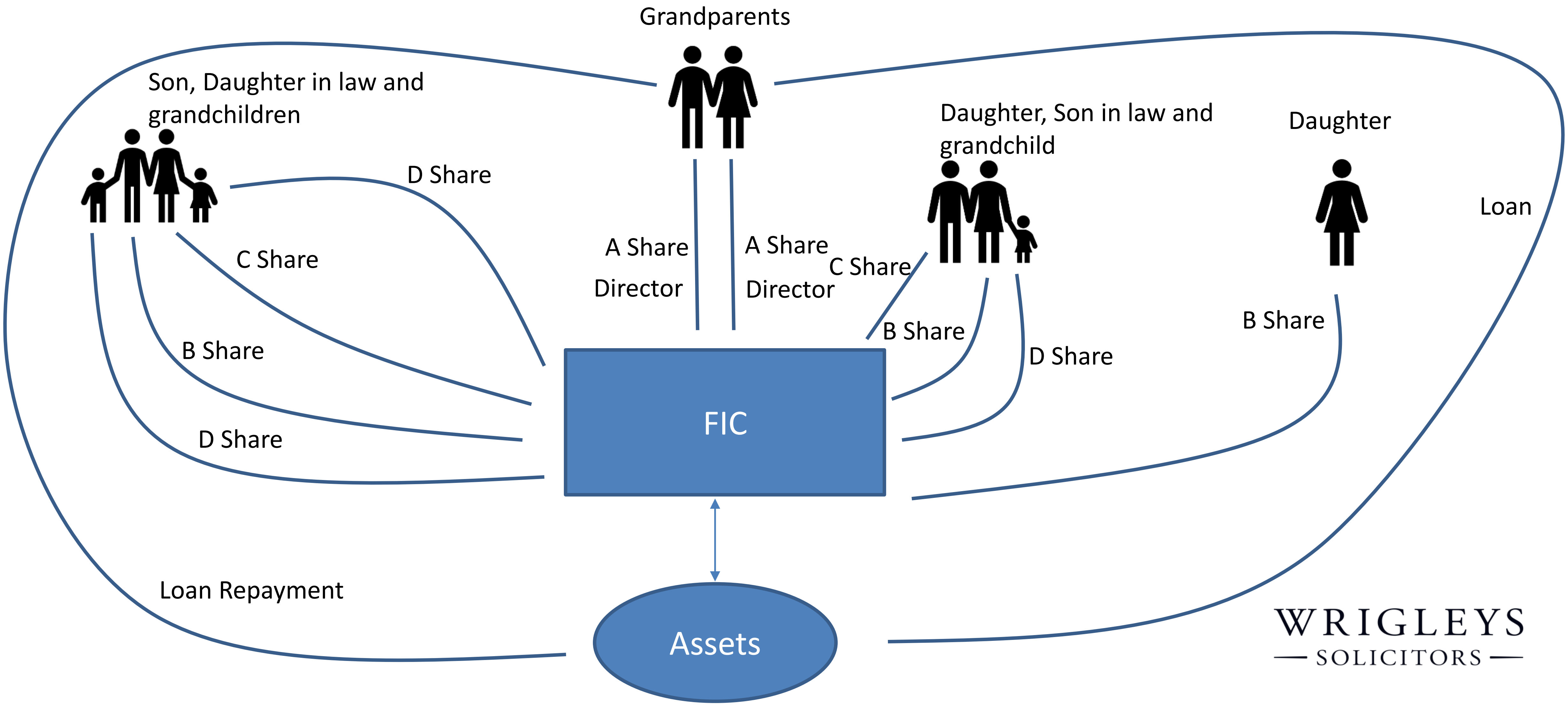
The general approach to estate planning is not to mitigate care fees entirely but to allow for flexibility and control when dealing with the issue.

In this respect, the proposed changes to the legislation shouldn’t impact our approach in utilising life interest or discretionary trusts.

Family Investment Companies – an alternative to traditional trusts

- At root, an FIC is simply a company.
- An FIC is a family company, set up by an older generation that wishes to transfer wealth to a younger generation (and beyond) in a structured way.
- There are often multiple classes of shareholders.
- Rights attached to the shares will often differ depending on the age or generation of the shareholders.
- FICs are not trading companies, they hold investments often in the forms of cash, shares or property.

Typical Structure



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Possible ‘pros’ and ‘cons’ of FICs v Trusts

In some ways, FICs and Trusts are similar:

- The directors of an FIC, and the trustees of a Trust, are obliged to manage assets for the benefit of the underlying beneficiaries/shareholders.

- Directors and trustees make day-to-day decisions concerning the management of the FIC/Trust and maintain a significant level of control.

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Pros

- Inheritance tax on creation:
- Funding: An FIC can be funded in a number of ways: Subscribing for shares and/or a loan
- Ongoing IHT charges: none
- Taxation of income and capital gains: at the corporation tax rate and Dividend income
- received by FICs from other companies can be tax free if relevant conditions are met
- Bringing the younger generation onboard:
- Capital growth: It is possible to finely calibrate when capital growth will accrue to particular classes of FIC shares, using 'growth shares' and 'freezer shares'. This can be useful in relation to IHT planning.
- Discounted value of shares for IHT: For IHT purposes, the value of individuals' shareholdings can be discounted to reflect the number of shares held and the rights of the class of shares held.

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Cons

- **Setting up**: It costs more to set up an FIC than a Discretionary Trust.
- **Capital gains tax on creation**: If an FIC is funded by transferring assets to the FIC, there may be a capital gains tax (CGT) charge.
- **Double taxation of income:** There can be a double layer of taxation if and when an FIC's post-tax profits are paid to shareholders as dividends.
- **Compliance work**: FICs are subject to greater public reporting requirements than Trusts, even when an FIC is set up as an unlimited company.
- **Who can benefit**: An FIC can only distribute money to its shareholders.
- **Winding up**: Generally, FICs cannot be wound up as easily as Trusts.

Changes to the guidance for LPAs on Discretionary Fund Management

- The Office of the Public Guardian's ("the OPG") guidance on making Lasting Powers of Attorney advises that a specific instruction is required to allow attorneys to deal with investments managed by a bank or external provider (Discretionary Fund Management "DFM").
- An Agent/attorney cannot delegate their authority and that they must carry out their duties personally
- As an attorney is able to delegate decisions which they do not possess the relevant expertise to undertake, this would apply to transferring funds into a DFM scheme and would be permitted on the condition that the attorney believes what they are doing is in the best interest of the donor.
- There should be no problem in omitting advised instruction allowing an attorney to use DRM providers from LPA's in future and there should be no further issues from DFM providers in the future.
- However, continuing to include the aforementioned instruction within the LPA is still advisable, until the OPG update their guidance on the basis that it avoids any costly arguments by the DFM providers.

The importance of updating pre RNRB Wills

- In addition to the inheritance tax (IHT) standard nil rate band, a residence nil rate band (RNRB) was introduced from 6 April 2017 which currently stands at £175,000.

- The RNRB can be used only by those who held a ‘qualifying residential interest’ at some time during their lifetime. Simply, they need to own or have part ownership of a property that was their residence at some point during the period of ownership. The ‘qualifying residential interest’ must be ‘closely inherited’, i.e. passing to direct descendants.

- If a qualifying residential interest is placed into a discretionary will trust, it will not qualify for the RNRB, even if the beneficiaries are limited to direct descendants. However, if the trustees appoint the qualifying residential interest to direct descendants, within two years, the RNRB could potentially be claimed.

However…

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- Pre 2017, most well drafted life interest trust will have contained discretionary powers to be able to distribute capital and income to beneficiaries other than the life tenant. If these powers were not restricted to the life of the life tenant then the RNRB will be lost.

- It is therefore very important for clients to review their Wills, particularly if they were drafted before 2017.

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ANY QUESTIONS?

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