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# You Can't Take it With You - Using Trusts to Avoid CGT

Specialist property accountant **Stephen Fay** ACA considers how property investors can use a trust to mitigate CGT on asset transfers.

Some readers may have seen the recent BBC programme called 'You can't take it with you'. The programme features a range of scenarios which enabled asset-owners to pass on wealth to loved ones tax-efficiently. For property investors, capital gains tax is often a major issue when passing on assets before death.

**What is a trust?**

A trust is a legal arrangement whereby 'trustees' are made legally responsible for assets (e.g. property, cash etc) held in trust for the benefit of 'beneficiaries.'

Trustees manage the trust and carrying out the wishes of the person who has put the assets into trust (the 'settlor'). The settlor's wishes for the trust are usually written in their will or given in a 'trust deed'.

**Why use a trust?**

Trusts are most commonly established to pass on assets and cash to loved ones. Assets may be placed in a trust on death (a 'will trust'), or during one's lifetime. The trust capital may produce an income, such as rental profits, and assets may be sold - as such, trusts pay income tax and capital gains tax.

Trusts are flexible, tax-efficient ways of making gifts. Gifts may be made to beneficiaries not yet born, to enable the income from an asset, and the asset itself, to be given to different people, and also enable a 'life interest' to be created (e.g. a beneficiary may occupy a property until death, and the property may pass to another person on the death of first beneficiary).

**Why are trusts useful to property investors?**

Where property has increased in value and is gifted to another individual, this 'disposal' normally gives rise to a CGT charge. This acts a major barrier to landlords wishing to pass on their assets to, typically, family members.

Since June 2010, investors now pay CGT between 18-28% on the 'gain' arising when gifting an asset. As no money changes hands (it's a gift, after all), this can cause a problem as there is a tax bill to pay but no sale proceeds!

For example, a Higher Rate taxpayer gifting a property with a £50k net gain (after expenses/allowances) to a family member would crystallise a £14k CGT bill (payable along with the usual income tax bill each January). If the investor has no sales proceeds, finding £14k in cash can be an issue!

This is where using a trust - in particular a discretionary trust - can prove useful.

**Discretionary trusts - the landlord's friend**

The trustees of a 'discretionary trust' have discretion about how to use the trust income, and possibly capital. Trustees decide how much income or capital is paid, to whom, how often and when, and may impose conditions on the payments. The investor can set guidelines to influence the trustees so that funds are used for their intended purpose.

As many investors accumulate substantial wealth, using a discretionary trust enables wealth to be passed to beneficiaries in a carefully-controlled way, rather than in large lumps of cash. Trustees have discretion to use the funds as directed, but bearing in mind the needs, age, and maturity of each beneficiary.

**Holdover relief - the landlord's gift**

'Holdover relief' enables investors to transfer property into a trust and avoid paying CGT on the transfer - as would normally be the case for gifts and transfers. In effect, the ▶

trust 'takes over' the original cost of the asset, and so will itself pay CGT when the trust sells the asset (the original cost is the base cost, not the value on transfer).

This enables the asset, and its income, to transfer indirectly from the investor to a loved one without any CGT being payable on transfer. There are some specific rules to follow for this to be the case, notably that the transfer gives rise to an inheritance tax liability (which itself may not be immediately payable).

For example, the above Higher Rate taxpayer would transfer the property into the trust, and claim holdover relief to avoid an immediate tax charge. The trust would 'inherit' the purchase price from the investor, and CGT would be paid only when the trust sells the asset - in the meantime, the family can benefit from the income provided by the asset.

Holdover relief must be claimed - it is not automatic - and does not apply where the beneficiary retains an interest in the trust.

**Transfers back out to loved ones**

With careful planning, it's possible to transfer assets back out to family members dirctly, and avoid paying tax on the transfer into, and out of, the trust. This enables often significant CGT to be avoided. This requires planning to ensure dates and circumstances allow tax to be avoided - but, contrary to some advisers' opinion, this is possible.

**The bad news - kind of**

There had to be some bade news! It's the income tax rate that trusts pay: 50%! This is also compounded by a measly £1,000 'personal allowance' for trusts.

However, the better news is that, similar to when companies pay out dividends, the payment out to the beneficiary is deemed to have 50% 'tax paid' - allowing the beneficiary to claim back the difference between their own tax bill and the 50% paid by the trust. Effectively, this means that Basic Rate taxpayers only pay Basic Rate (20%) income tax on the trust income received.

**Summary**

Trusts, and in particular discretionary trusts, offer a method for a landlord to pass on assets to family and avoid paying CGT on transfer. How the funds are to be used, and when, can also be indicated to trustees, and so provide comfort that wealth won't be squandered.

Although the income tax regime seems harsh, with careful planning and payments to beneficiaries, this can be dramatically reduced. However, come what may, all landlords will meet their maker - and they can't take their properties with them - so 'end of life' planning should not be left to chance! PIN

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