

MAKING A GIFT OF THE FAMILY HOME

General Matters

Part One

This standard guidance is issued in conjunction with our general terms of engagement. The guide is produced for our clients and we take no responsibility for persons relying on its contents who are not clients of Smith Law Partnership Solicitors. The guide is issued in compliance with The Law Society guidance on gifting with the intention of providing protection to all clients considering making a gift of their home.

If you wish to make a gift of your home during your lifetime, you can make an outright gift or you can make a gift of the property to a trust. These two methods are discussed separately. Part Two of the Guide outlines the implication of a gift on long term residential or nursing care fees.

A. Outright Gifts

The reasons for making outright gifts of the family home.

Some of our clients decide that they might want to make a gift of the family home to their children or other relatives. There are many reasons for considering making such a gift:

- 1. Affection** for the recipients and a wish to see the benefit of the gift enjoyed by the recipient during your lifetime rather than under the terms of your Will.
- 2. Moral obligations.** You may feel it appropriate that certain family members receive a gift of value from you.
- 3. Financial obligations.** You may wish to recognise the contribution which a family member has made to your property, your lifestyle, your personal choices.
- 4. Avoiding family issues or disputes** by making the gift of the family home during your lifetime.
- 5. Avoidance of delays following your death.** A Grant of Probate would be required if you retained the property in your sole name at death. You may not need a Grant of Probate if you gift the property.
- 6. Passing of the burden of owning property to the family.** You may want to pass the burden of owning a property to the next generation. For example, they may agree to then keep the property maintained, repaired and insured at their own expense. We recognise that some people feel that there is peace of mind to be gained by being free from property ownership, likewise paperwork relating to property ownership.

However it is important to note that for most people the family home is their main valuable asset. By giving this valuable asset away you may leave

yourself in a financially insecure position and limit your life choices in future. There are many reasons to be cautious about making this decision.

It is very important that you are aware that we do not usually recommend that clients make an outright gift of their family home even to their children.

Reasons for being cautious about making outright gifts of your home

There follows a list of our concerns for our clients making an outright gift of their home.

1. Financial difficulties of the recipient of the gift. If the recipient has financial problems or becomes bankrupt then your property may be lost to creditors.
2. Divorce of the recipient. If a child gets divorced then your home will become part of his/her assets in determining the divorce settlement.
3. The recipient is on means tested benefits or begins receipt of means tested benefits, for example after losing their job. The property will be treated as his/her asset under means testing requirements.
4. With gifts requiring the recipient to take control of the property in respect of repair, maintenance, insurance etc then we need to ensure that the recipients are aware of and accept the responsibility.
5. The family falling out. Unfortunately this does happen sometimes when/where we least expect it to occur. Third parties can put pressure on a recipient to try to mortgage the property, sell it or gift it. We cannot foresee what will occur in the future and it may be that recipients are influenced by third parties, whose identity is unknown at the time of the gift.
6. The death of the recipient. If the recipient dies then the asset will pass under the terms of his/her Will or if they have no Will under the Rules of Intestacy. This could mean that a daughter-in-law or son-in-law could benefit and the grandchildren.

Inheritance Tax Implications

Please be aware that a gift in these circumstances will not have the effect of saving inheritance tax.

Capital Gains Tax

This is not a tax that is as well known as inheritance tax because generally our home is exempt from capital gains tax which taxes the increase in value

of our assets. However if you make an outright gift of the property then capital gains tax will be applicable. This aspect will need to be explained to you in more detail if you do decide to make an outright gift.

Expectations of or from recipients

To be frank, some recipients do not feel the moral obligations that might be expected from them. Once a gift has been made you lose control of your home and you may seriously limit your ability to look after yourself in future.

Long term care provision

This is a complex area and we ask you to take careful note of the advice in Part Two of this Guide concerning the impact of making the gift of your family home on your long term care arrangements.

It is possible to make an outright gift of your home to your children or other person or persons. If you do decide to make an outright gift against our advice then we can assist you in the transfer. Please do however contact us to discuss this most crucial decision.

B. Gifts to Trusts

TRANSFERRING YOUR FAMILY HOME TO A LIFE INTEREST TRUST (FAMILY TRUST)

Instead of transferring the family home outright you can consider making a gift to a family trust.

What is a Trust

The trust is a relationship which is recognised and enforceable in the court. Its details are contained in a trust deed which is rather like a rule book. A trust has its own bank account, assets and tax reference. When a trust is established it has to be registered with the HM Revenue & Customs. It pays income tax, inheritance tax and capital gains tax in its own right. A trust is governed by trustees. They look after the property deciding what will happen to it on behalf of named beneficiaries. You and the beneficiaries can be trustees but this can sometimes create a conflict of interest. There must be a minimum of two trustees and a maximum of four trustees.

Responsibilities of Trustees

The trustees must always act in the best interest of the beneficiaries. They have very wide powers to act in this way and can take advice in this respect. They have wide powers to invest money, insure property, lease and mortgage it. We use the standard provisions of the Society of Trust and Estate Practitioners as they provide the necessary administrative provisions for the trust to operate. The trustees are required to keep trust records and hold trustee meetings on an annual basis. They must also make sure that they carry out the terms of the trust and not go beyond their powers. A trustee must never profit from their role as a trustee and must act impartially and fairly between the beneficiaries entitled to benefit from the Trust now and in the future. There is no doubt that Trustees' responsibilities are onerous and there are occasions when at least one professional trustee should be appointed.

The terms of the Trust

The beneficiary will usually be you as the person occupying your home for the duration of your life. On your death the trust will end the property will then pass to the recipient/children. The terms of the trust however can be tailored to your own individual circumstances and we can discuss these with you in detail.

Continuing to live in your own home

During your lifetime you benefit from what is presently your home. You can live in the property as now or if your home is sold the proceeds can be used to purchase another property for you. Alternatively the proceeds can be invested so as to generate an income for you. However, you do need to be aware that having a property in a trust is not the same as having it in your own name. The trustees can override your interest in the property and in respect of any proceeds of sale if they have reason to do so which can be justified by law. This is another reason why we sometimes recommend that at least one professional trustee is appointed.

Why might a family trust be better than making an outright gift of your family home?

1. Matters as to affection and moral obligations can be fulfilled by founding a family trust.
2. In respect of financial obligations, founding a family trust can formally recognise the contribution which a family member or other person has made to the property and to your lifestyle or personal choices.
3. Forming the trust can be used to promote family harmony and avoid problems on death.
4. The property in a family trust can be sold without a Grant of Probate and this avoids delays on death.
5. Passing on the burden of owning a property to the family can be achieved with the trust. The financial burden can be met by the trustees and beneficiaries if they agree and if you feel peace of mind will be gained by being free from property ownership then this will also be achieved through the trust.
6. You retain a place to live for as long as you wish and you also retain an income should the property be sold or rented out.
7. It is important to note that the trustees do not own the property in the trust fund outright. This is an important distinction between using a trust and using an outright gift. The property does not belong to family members until your own death and is not therefore available to the recipient's creditors or other third party claimants. Your position is more protected by using a family trust than making an outright gift.

The main disadvantages of setting up a family trust?

1. Where a property has been transferred to a family trust, the trustees decide what will happen with that property although they must operate within the terms of the trust. It is not the same as owning your own property when property has been placed in a trust; there is an element of loss of control.
2. If you wish to raise a loan on your property then you will not be able to achieve this.

Other matters

Some of the following information is technical and is subject to changes in the law. As it is likely that the family home is to be the main asset of the trust then some of the tax issues listed are not likely to be relevant.

Record Keeping

It is wise for trustees to keep records of receipts and payments and other transactions relating to the trust. This can be important for tax and other practical purposes. Any important transactions should be carried out only after taking legal advice to avoid problems, but that is similar to the situation where you are considering doing something with your own money. The trustees should meet at least once a year to discuss the terms of the trust and the practical issues such as repair and maintenance etc.

Buildings Insurance

If the home is placed into a trust then the buildings insurance must be transferred into the names of the trustees. This is because the house is in their name. Insurance brokers do not usually charge for this. Contents cover should remain in your own name as the contents will remain your own.

Tax Matters

Whilst you still live in the home held within the trust tax matters should not have a great impact. Even after a sale it should be straight forward. All trusts must be registered with the Capital Taxes Office of H.M. Revenue and Customs and we will do this for you. The yearly tax return looks complicated but usually there will be little if anything to include within it. Again we can assist in this respect and sometimes we are successful in seeking Revenue approval for the trust not to receive an annual trust tax return.

Inheritance Tax

Provided that the value of your home is below the inheritance tax threshold which is currently £312,000 inheritance tax is neither saved nor increased by transferring your home into a trust. It is not a part of a tax planning scheme. There is no inheritance tax charge on founding a family trust for houses valued under £312,000. If your home is valued close to or over that amount, you will need to tell us and we will explain to you the best way to proceed. There may well not be any inheritance tax to pay after all but care is needed. Inheritance tax will not be payable on your death unless than you have more than £312,000 in total assets including the home and certain gifts made within 7 years of death. If all your assets, including trust assets pass to a surviving spouse no tax is payable on that death whatever value is to be involved. On the survivor's death if the £312,000 limit is exceeded, inheritance tax may fall due at 40% of the surplus above £312,000. Specific advice would be required at the time.

Capital Gains Tax

There should not be any capital gains tax payable on the transfer of your home into the family trust. This is because the principal private residents exemption for capital gains tax applies on entry to the trust and subsequently. Please note that this does not apply to property held after an outright gift to a person who does not live there. If you have not always lived in the property whilst you owned it then there can be a capital gains tax charge upon setting up the family trust. Also if you cease to live there for a few years and then it is sold there can sometimes be capital gains to pay. This is all the same as if you owned the property in your own name. If there are other assets held in the trust apart from cash then the current capital gains tax which would be applicable would be your actual own income tax rate. Consequently if you are a higher rate tax payer this could be as high as 40%. Please note this is an exception to the general 18% capital gains tax

rate introduced in 2008-2009 for individuals, trusts and personal representatives.

Income Tax

There is no income tax chargeable upon founding a trust. Whilst you live in the home within the trust you will not pay a rent for that residence. If however you leave the property and it is let out, or the sale proceeds of the property generate an income because the proceeds of sale are invested, the tax liability is set at the lower rate basic rate depending on the type of asset involved. Please note if you are a higher rate tax payer extra tax up to that rate may be due from you.

Stamp Duty Land Tax

Unless there is money paid for the transaction from the recipient or family member there is no tax to pay on founding the family trust. There may be stamp duty land tax to pay if the property is sold and another is purchased for you to live in. The amount depends upon the cost of the new property. This is the same as if the property was in your own name. Please note that if your home is subject to a mortgage then the transfer into a family trust may not be possible. Even if it were agreed with the lender that there might be a transfer to the trust there might be a charge to stamp duty land tax because the liability to pay the mortgage would count as consideration i.e. money paid for the transaction and that the trustees will be taking on. The tax will depend upon the value of the outstanding loan.

The pre-owned asset tax

In some situations when property remains occupied by a person who has previously disposed of it, there is a special charge to be income tax and a schedule 15 to the Finance Act 2004. This does not apply where you have an interest under family trust. It only applies in special circumstances usually involving complex inheritance tax planning schemes.

In short the foundation of a family trust and its administration should not deter you from founding such a trust if you believe it is right for you.

In addition please also consider the benefits and necessity of

- Keeping your Will up to date

- Have a Lasting Power of Attorney, allowing your chosen person to act on your behalf in the event that you are not capable of acting for yourself
- Keeping up to date with inheritance tax.

Please contact Susan Carlile for more information 01376 321311.