REVOCABLE INTERESTS IN POSSESSION

Alan Pink[1]

A Possible IHT Planning Device Using The Principal Private Residence

A great deal has been said at various times and in various places concerning the mitigation of inheritance tax using the taxpayer's and his or her spouse's main residence. In many cases, there will be no significant assets which can be made the subject of IHT planning other than the main residence (for example, where the only other major asset is shares in an unquoted trading company which currently qualify for 100% business property relief). The basic problem in this situation is utilising the nil-rate band on first death in the context of a will whose basic intention is to leave everything to the surviving spouse.

Very often the inheritance tax advantages of alienating a portion of the main residence are tempered by the capital gains tax disadvantages of making some or all of the main residence a non-exempt asset. This applies particularly to the scheme involving carving out a lease and gifting the freehold reversion, but also applies to the outright gift of a share in the property to the taxpayer's children.

The clue to one possible solution to this problem may be found in James Kessler's article in *Taxation Practitioner* of November 1990, at page 533. The learned author suggests that a testator may leave his interest in the home to a settlement under which his children have an interest in possession in an appropriate share. The trustees can be given "appropriate powers" to protect the security of tenure of the surviving spouse.

The writer believes that this can in fact be used to create an absolutely safe legacy, the subject matter of which can also be made entirely exempt from capital gains

[1] Alan Pink, BA, MPhil, ACA, ATII, Partner, McCabe Ford Williams, 16 Havelock Road, Hastings, East Sussex TN34 1BP. Tel: (01424) 444317 Fax: (01424) 433714.

tax. This is by making use of the under used and underrated device of the revocable interest in possession.

Suppose husband and wife are joint owners of their main residence which is worth £400,000.

Suppose further that the husband makes a will to leave his share of the property (which he has previously converted into a tenancy in common) to a trust in which his spouse has an interest in possession of an amount equivalent to £50,000 and the children of an amount equivalent to £150,000, thus achieving the maximum use of the nil-rate band on first death which might otherwise be wasted if the entire estate goes to the surviving spouse.

The will trust, however, makes the interest in possession revocable. The practical purpose of this is in order to prevent the children making use of their rights under the interest in possession to the detriment of the spouse. It is felt that in 99 cases out of 100 it will not be necessary to revoke the interest in possession, as the children will not be interested in occupying or otherwise enjoying the house or the proceeds of its sale during their surviving parent's lifetime.

The inheritance tax planning is thought to work, however, because the children are deemed under s.49 IHTA 1984 to acquire an absolute interest in the legacy represented by the will trust. The Inland Revenue have made it clear (in their Press Release dated 12th February 1976) that a power of revocation does not prevent an interest from being an interest in possession. Hence it is outside the surviving spouse's estate on his or her subsequent death.

By making the entire share into settled property in which the surviving spouse has an interest in possession, any gain made by the trustees on a disposal of the property during the surviving spouse's lifetime is brought within s.225 Taxation of Chargeable Gains Act 1992. The fact that the house is not, probably, resided in by the "majority" beneficiaries does not prevent that exemption from applying.

Only if it is necessary to revoke the interest in possession for the children in favour of the surviving spouse will the inheritance tax planning be ineffective, the property becoming thereby part of the surviving spouse's estate for IHT purposes in its entirety.