



November 2020 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part I Suggested Answers

1. As Jonathan died on a Sunday, the units should be valued on Friday 14 June (1/2) which was the last preceding business day. (1/2)

The units in the unit trust are valued using the lower of the bid and offer prices quoted (1/2), which will be the bid price. (1/2)

The accrued income of £200 should be included in the value of the units for IHT purposes (1/2), with a 20% deduction for the Income Tax which will be payable by the executors (1/2).

(3 Marks)

2.

	£	
PET from Charlotte to Joan (using loss to donor): 180,000 – 50,000	130,000	1
Fall in value relief (using loss to donee) 35,000 – 20,000	<u>(15,000)</u>	1
Chargeable PET	<u>115,000</u>	
Nil rate band remaining: 325,000 – 130,000	<u>195,000</u>	1

(3 marks)

3. Michael would like his gifts to be treated as normal expenditure out of income (1).

For this to apply they must:

- be habitual or regular in nature(eg at each regular visit) (1)
- be made out of excess income, rather than capital funds (1)
- leave him with sufficient income in order to maintain his usual standard of living (1)

(4 marks)

4. Maria's land meets the conditions for APR as follows:

- it is agricultural land (1/2), in the UK or an EEA state (1/2)
- the land is used for agricultural purposes by the tenant (1/2)
- Maria has owned the land for more than seven years, which is the minimum ownership period for tenanted land (1/2)

APR will be available at a rate of 100% (1), since the letting agreement/lease was signed after 1 September 1995 (1).

(4 marks)

5. Step 1 – Calculate TNRB available from Floss’s estate.

This should take into account her chargeable lifetime transfers (1/2) and the legacy to her son on death (1/2). The remaining nil rate band available to be transferred should be calculated as a percentage (1/2) of the nil rate band in force at the time of Floss’ death (1/2).

Step 2 – Calculate TNRB available from Bonnie’s estate.

As Bonnie only used half of her nil rate band on death and made no lifetime transfers (1/2), the available transferable nil rate band is the other 50% (1/2).

Step 3 – Calculate TNRB available to Finn

Add the unused percentages for Floss and Bonnie’s estates (1/2), but it is restricted to the maximum allowed of 100% (1/2). This is multiplied by the NRB in force (£325,000) at the date of Finn’s death to give the TNRB available to his estate of £325,000 (1/2).

(Max 4 marks)

6.

	£	
Current value of trust	778,000	1/2
BPR at 100% on Maker Ltd shares	<u>(258,000)</u>	1/2
	520,000	
NRB 2019/20	<u>(325,000)</u>	1/2
	<u>195,000</u>	
Notional tax: 195,000 x 20%	39,000	1/2
Effective rate: 39,000/520,000	7.500%	1/2
Actual rate: 7.500% x 30%	2.250%	1/2
Tax payable (on investment portfolio only) 520,000 x 2.250% x (40 – 7*)/40	<u>9,652</u>	1/2
*quarters from 18 January 2010 – 10 January 2012	7	1/2

(4 marks)

7. Life insurance policy gains are subject to Income Tax (1).

If Fergus died on 10 August 2018, the trustees would be taxed on the gain (1/2).

If Fergus died on 10 August 2019 his executors would be taxed on the gain (1/2).

(2 marks)

8.

Cash – not chargeable to CGT	£	nil	1/2
Painting – chattels exemption applies		nil	1/2
Antique clock			
Deemed proceeds (MV)		30,000	1/2
Less – purchase cost		<u>(8,000)</u>	1/2
		22,000	
Less annual exemption 2019/20		<u>(12,000)</u>	1/2
Taxable gain		<u>10,000</u>	
Capital Gains Tax at 20%		<u>2,000</u>	1/2

NB 5/3 chattels rule not applicable as cost was greater than £6,000

(3 marks)

9.

1) Entrepreneurs' relief is available (1/2) on the disposal of the shares Seeds Ltd by the trust, as the following conditions are met:

- There is at least one beneficiary who has a life interest in the trust - Mark (1/2)
- Mark owns at least 5% of the shares in Seeds Ltd personally (1/2)
- Mark is an officer or employee of the company (1/2)

The trustees and beneficiary must make a joint claim for the relief (1/2)

(Max 2 marks)

2)

CGT on disposal of the shares:	£		
Proceeds:		48,750	
Less – purchase cost (MV at date of purchase)		<u>(20,000)</u>	1/2
		28,750	
Less annual exemption 2019/20 (halved as one other trust created by settlor)		<u>(3,000)</u>	1
Taxable gain		<u>25,750</u>	
Capital Gains Tax at 10% re Marks proportion and 20% re other grandchildren's proportion		<u>2,575</u>	1/2

Tutorial note: the 10% should only apply to the proportion of the gain relating to Mark, with 20% applying to gains relating to grandchildren who will not give eligibility to entrepreneurs' relief. As the question did not state the number of grandchildren then credit was given for any reasonable apportionment (including the full gain at 10%).

(2 marks)

10. Hattie's 2019/20 Income Tax position

	Savings £	Dividend £	
Bank interest	18,500		
Dividends		<u>7,000</u>	
Personal Allowance	<u>(12,500)</u>		1/2
	6,000	7,000	
Tax payable:			
Starting rate band – 5,000 x 0%	0		1/2
Personal Savings Allowance – 1,000 x 0%	0		1/2
Dividend allowance – 2,000 x 0%	0		1/2
(7,000 – 2,000) x 7.5%	<u>375</u>		1/2
Total	375		
Less tax paid by trustees (3,700 + 525)	<u>(4,225)</u>		1/2
Repayment due to Hattie	<u>3,850</u>		

The trustees would not be required to notify HMRC if the only source of income is interest (1/2) and the resulting tax liability is under £100 (1/2).

(4 marks)

11. The following people would be connected to Nigel for Capital Gains Tax purposes:

- Gordon (1/2)
- Bob (1/2)
- Bob's children (1/2)

and nobody else (1/2)

Tutorial note: the final 1/2 mark was given where candidates simply added no other individuals to the list of connected persons.

(2 marks)

12. Income in a discretionary trust will be treated as relevant property if it has been formally accumulated to capital by the trustees (1). Income which has been unaccumulated and undistributed for more than five years before a 10 year charge is also treated as relevant property for the purpose of calculating the charge (1).

Other examples of relevant property would be:

- Capital assets held on a discretionary trust created by a UK domiciled individual
- Capital assets held on a lifetime interest in possession trust created by a UK individual after 22 March 2006
- Capital assets held in an A&M trust which did not alter its terms before 6 April 2008
- Any two of the above (1)

(3 marks)

Marks will be awarded for any other valid examples.



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Part II Suggested Answers

13.

1) Exemptions and Inheritance tax calculation for gifts made by Dennis in lifetime during 2019/20:

14 May 2019	Gift to John	Not more than £250 so small gifts exemption available			$\frac{1}{2}$
30 July 2019	Gift to David	Over £250 so small gifts exemption not available			
			£	£	
		Gifted		350	
		Less: Annual exemption 2019/20	3,000		
			(350)		
			2,650	(350)	$\frac{1}{2}$
				Nil	
5 Oct 2019	Charity			Exempt	$\frac{1}{2}$
21 Oct 2019	Gift to James	PET		5,650	
		Less: Annual exemption 2019/20 (balance)		(2,650)	1
		Less: Annual exemption 2018/19		(3,000)	$\frac{1}{2}$
				Nil	
30 Dec 2019	Discretionary Trust	Chargeable Lifetime Transfer		550,000	
		Nil Rate Band 2019/20	325,000		$\frac{1}{2}$
	1 Jan 2013	Disc Trust for James	(400,000)		$\frac{1}{2}$
				(Nil)	
		CLT		550,000	
	Inheritance Tax payable		@ 20/80	£137,500	1

(5 marks)

2) Additional Inheritance Tax payable on the death of Dennis:

1 May 2016	PET now becomes chargeable as it is within 7 years of death		£	£	
				497,000	
2019/20	PET Nil Rate Band on death	325,000			
1 Jan 2013	CLT in the previous 7 years	(400,000)			
				(Nil)	½
				£497,000	
	Inheritance Tax @40%			£198,800	½
Taper Relief	Died 3-4 years after making the gift	@20%		(39,760)	½
	Inheritance Tax payable by James			159,040	
Dec 2019	Chargeable Lifetime Transfer- within 7 years of death		£	£	
	Gross Chargeable Transfer (GCT) on creation of a Discretionary Trust (£550,000 + £137,500)			687,500	1
2019/20	Nil Rate Band on death	325,000			
1 Jan 2013 and 1 May 2016	CLTs in the previous 7 years	(897,000)			
				(Nil)	½
				687,500	
	Inheritance Tax @40%			275,000	½
	<i>No Taper relief as not more than three years have passed between the date of the CLT and the date of death.</i>				
	Credit for Lifetime Tax			(137,500)	½
	Inheritance Tax payable by the trustees			£137,500	

(4 marks)

3) James has created a Bare Trust or nominee arrangement, as although his friend is acting as a trustee, he must follow James's instructions **(1)**

Although the transfer of the shares has been made into his friend's name so he has legal ownership, James has retained beneficial ownership **(1)**.

The dividend income still belongs to James and he will be taxed on the dividends in the tax year they are paid even if his friend does not pay the dividend to James **(1)**.

The shares will form part of James's estate **(1)**.

(Max 3 marks)

Marks will be awarded for any other valid comments.

4) Any three examples

- A summary of the services provided up to the date you cease (1)
- Details of any further action/services you will complete before ceasing (1)
- Details of any outstanding matters that James, or his new accountant, will need to action (1)
- Details of who will be advising HMRC of the change (1)
- An explanation to confirm whether you will be willing to help, or otherwise, with sending copy papers to the new accountant and resolving outstanding issues with HMRC (1)
- Details of any impending deadlines and the action that will be required (1)
- A note of any outstanding fees (1)

(Max 3 marks)

Marks will be awarded for any other valid comments.

(Total 15)

14.

1) 2019/20 Income Tax payable:

		Non-savings	Dividends	
Rental income	44,000			
Rental expenses:				
Repairs	(3,250)			
Insurance				
1/12 x £1,140	95			
11/12 x £1,200	1,100			1/2
	(1,195)			
Garden maintenance	(6,000)			1/2
Agent fees	9% x £44,000	(3,960)		1/2
		29,595		
Dividends – quoted			47,500	1/2
Dividends - ISA	EXEMPT		Nil	1/2
Savings interest				
Taxable		29,595	47,500	
Tax rates		20%	7.5%	
		1/2	1/2	
Tax due		£5,919	£3,562	
Total			£9,481	1/2

(4 marks)

2)

<u>Capital Gains Tax</u>	Rental cottage £	Shares-quoted £	
Sale proceeds	975,000	750,000	
Selling costs (6% x £750,000)		(45,000)	1/2
		705,000	
Probate value	(400,000)	(675,000)	
Improvements	(350,000)		1/2
	225,000	30,000	
Annual exempt amount – third tax year after death	(12,000)		1
Taxable capital gain	£213,000	30,000	
Capital Gains Tax payable @ 28%	<u>£59,640</u>		1/2
Capital Gains Tax payable @ 20%		<u>£6,000</u>	1/2
Total		<u>£65,640</u>	

(3 marks)

3) The executors will not get any tax relief for expenses incurred in managing the estate (1).

If the executors decide to take out a loan to pay the Inheritance Tax, they can get tax relief on the interest paid on the loan (1/2). Relief is only available for interest paid in the first 12 months of the loan being advanced (1/2).

(2 marks)

- 4) The 2020 tax return will need to be submitted electronically by 31 January 2021 (1/2).

The amount that will need to be paid by 31 January 2021 is:

	£	
Income Tax for 2019/20	9,481	(1/2)
First payment on account for 2020/21 (50%)	4,740	(1/2)
Capital Gains Tax for 2019/20	<u>65,640</u>	(1/2)
	<u>79,861</u>	

The normal time allowed for HMRC to open an enquiry is 12 months (1/2) after the date the tax return is delivered (1/2).

(3 marks)

- 5) The duties of his executors will start on the day following Ryan's death (1/2) and end when the duties have all been discharged and the administration of the estate has ended (1/2).

Their duties include:

Any two of the following:

- To obtain probate (1)
- To ascertain the assets and liabilities of Ryan's estate (1)
- To collect in Ryan's assets and preserve his estate (1)
- To pay estate expenses, debts and liabilities in administering his estate (1)
- To distribute his estate in accordance with the terms of his will (1)

Scots Law:

The duties of the executors start once they have obtained a grant of confirmation (1/2) and ends when the duties have all been discharged, unless the grant of confirmation is revoked (1/2).

Their duties include:

Any two of the following:

- To obtain confirmation (1)
- To ascertain the assets and liabilities of Ryan's estate (1)
- To collect in Ryan's assets and preserve his estate (1)
- To pay estate expenses, debts and liabilities in administering his estate (1)
- To distribute his estate in accordance with the terms of his will (1)

(Max 3 marks)

Total (15)

15.

- 1) Sammy is the life tenant of a Qualifying Interest in Possession and so the trust forms part of his estate in lifetime (1/2) and on death (1/2). The trust fund is therefore not relevant property so are not subject to Exit charges (1/2) or Principal charges (1/2).

(2 marks)

2)

- (a) Income Tax payable by the trustees:

	Dividend £	
Rental income		
Dividends	5,560	
Tax rate	7.5%	1/2
Income tax payable	£417	

- (b) Distributable income to Sammy:

	Dividend £	
Gross income	5,560	
Less: Tax paid	(417)	
Net income	5,143	
Less: Management expenses	(600)	1/2
	4,543	
Income distribution to Sammy:		
Gross income - £4,543 x 100 / 92.5	£4,911	1/2
Tax at source - Dividend tax £4,911 x 7.5%	£368	1/2

- (c) Income Tax position for Sammy

	Dividend £	Non-Savings £	
Employment income		12,500	
Less: Personal Allowance		(12,500)	1/2
Trust income at 7.5%	4,911		
Less: Dividend Allowance	(2,000)		1/2
Taxable	2,911		
Tax rate	7.5%		
Income tax payable	218		1/2
Less: Tax at source	(368)		1/2
Refund due	£(150)		

(4 marks)

- 3) As Sammy is the life tenant of the trust, he is legally entitled to the income of the trust (1). The trustees have no powers to accumulate income into capital. (1).

Scots Law:

As Sammy is the life renter of the trust, he is legally entitled to the income of the trust (1). The trustees have no powers to accumulate income into capital. (1).

(2 marks)

- 4) As the terms of the trust give capital to Jane at age 25, the trust is an “18-15” trust (1/2). There would have been no Exit charges if capital had been distributed to Jane before she attained age 18 (1/2). Capital distributed to her between the ages of 18 and 25, is subject to exit charges (1/2). The trust is not subject to any Principal charges (1/2).

(2 marks)

Marks will be awarded for any other valid comments.

5)

		£	£	
Initial value of the trust	30 Sept 2001		650,000	
Nil Rate Band	2019/20		<u>(325,000)</u>	1/2
			325,000	
Notional Tax	@ 20%		65,000	1/2
Effective Rate	65,000/650,000	X 100	10%	1/2
Actual Rate	10% x 30%	X 12(*)/40	0.9%	1/2
Inheritance Tax due	£75,000	X 0.9%	£675	

Alternative = £75,000 x 0.9/100 = £681

(*) 12 complete quarters between Jane’s 18th birthday on 30 September 2016 and the distribution on 30 September 2019.

(2 marks)

- 6) As the annual tax return was submitted late, an initial fixed penalty of £100 will have been issued (1/2).

In addition, as the tax return was later than three months after the filing deadline, HMRC may issue daily penalties of £10 per day (capped at 90 days) (1/2).

(Max 1 mark)

- 7) If a complaint is found to be justified, a member should:

- Promptly acknowledge the complaint and make an apology (1).
- Consider whether a claim for professional negligence could arise and seek legal advice if needed (1).
- Consider whether to inform professional indemnity insurers and obtain their approval before any response or apology is made (1).

(Max 2 marks)

Total (15)

16.

1) Exit charge on 15 July 2019:

		£	£	
Value of trust	31 March 2017		685,000	
Nil Rate Band	2019/20	325,000		1/2
CLT in 7 years before creation		(100,000)		1/2
Distributions in prev. 10 years	25 March 2015	(206,600)		1/2
			<u>(18,400)</u>	
			666,600	
Notional Tax	@ 20%		133,320	1/2
Effective rate	133,320/685,000	X 100	19.463%	1/2
Actual rate	19.463% x 30%	X 9/40	1.31%	1/2
Inheritance tax due	£250,000	X 1.31/(100 - 1.31)	£3,318	1

(5 marks)

2)

		£	£	
Flat transferred to Ben			250,000	
Base cost of the flat			(50,000)	
			200,000	
Less: Capital loss in 2019/20			(7,500)	1/2
			192,500	
Annual Exemption				
2 trusts by Settlor	6,000 / 2		(3,000)	1/2
			£189,500	
Capital Gain Tax		@ 28%	£53,060	1/2

Principal Private Residence relief is denied in full since a Gift Relief claim was made by the settlor on transfer of the property into trust. (1).

(3 marks)

3) The tax pool can only be used to frank any income distributed to the beneficiaries on the wind up of the trust (1). Any balance on the tax pool is lost (1).

(2 marks)

4)

- (a) The maximum lifetime of a trust will be defined by the governing law of the trust (1). For example, under English law, any new trust settled on or after 6 April 2010 cannot last for more than 125 years (1). This is known as the law against perpetuities (1).
- (b) When a trust ends, the trustees transfer all the trust property to the remaindermen absolutely (1).

Scots Law:

A trust period is defined by law (1).

A trust is governed by the rules that applied when the trust was set up (1). Any new trust settled on or after 6 April 2010 cannot last for more than 125 years (1).

When a trust period ends, the trustees must bring the trust to an end and transfer all trust property to the beneficiaries absolutely (1).

(Max 3 marks)

Marks will be awarded for any other valid comments.

5) The possible fee arrangements could include:

- Time and expenses – based on time spent and the skill and resources used (1).
- Fixed fee – based on the work required, skills and resources needed (1).
- Contingent fee – based on a reward or an outcome (1).
- Insurance – based on fees being covered by a professional fee insurance (1).

(Max 2 marks)

Total (15)