



November 2022 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part I Suggested Answers

1. It is unlikely that Alfonso acquired a UK domicile of choice when he returned to the UK as he did not intend to stay indefinitely (1/2).

Alfonso meets the conditions to be treated as a “formerly domiciled resident” as follows:

- He was born in the UK (1/2)
- His father had a UK domicile at the time he was born (1/2), therefore Alfonso had a UK domicile of origin (1/2)
- He was UK resident at the time of his death (1/2)
- He would have met the conditions to be resident in the UK in 2020/21 under the statutory residence test (1/2), meaning he was resident in the UK in one of the two tax years immediately preceding his death (1/2)

He will therefore be deemed to be UK domiciled for Inheritance Tax purposes (1/2)

Total

MAX (3)

- 2.

		£	
Total worldwide estate		900,000	
Nil Rate Band	325,000		1/2
Residence Nil Rate Band	175,000		1/2
		(500,000)	
		400,000	
IHT at 40%		160,000	1/2
Double tax relief, being the lower of:			
- The overseas tax suffered	30,000		1/2
- The UK IHT on the villa: 150,000/900,000 x 160,000	26,667		1/2
		(26,667)	1/2
IHT payable on Alex's estate		133,333	
Total			(3)

3. Sally has created a valid life interest trust through her instructions as follows:

As the trust is not of land i.e., it is of cash, there is no requirement for the trust to be executed via deed. Oral execution is sufficient. (1/2)

The trust property consists of a chose in action – cash of £300,000, by physically passing this to Tom's mother Sally this has completely constituted the trust (1/2).

The three certainties exist:

- There is a certainty of intention as she clearly directs the money is to be held on trust for Tom as primary beneficiary (1/2)
- There is a certainty of subject matter being the £300,000 (1/2)
- There is a certainty of objects (1/2) as Tom is clearly the primary beneficiary of the trust, with his daughter Lucy as remainderman and both Tom and Lucy are named as discretionary beneficiaries along with Lucy's remoter issue who are easily identifiable (1/2)

Due to the restrictions which would end Tom's life interest and create a discretionary trust on his/his family's behalf if he becomes bankrupt or tries to sell his life interest (1/2), the trust is special type of trust called a protective trust (1/2).

* Scotland:

Due to the restrictions which would end Tom's life interest and create a discretionary trust on his/his family's behalf if he becomes bankrupt or tries to sell his life interest (1/2), the trust is called an alimentary life rent (1/2).

Total (4)

4.

	£	£	
Initial value of trust property		675,000	1/2
Initial value of related trust:			1/2
*only other 18-25 trusts set up on same day included		nil	
		675,000	
NRB 2021/22	325,000		1/2
CLTs	nil		
Nil rate band remaining		(325,000)	
		350,000	
Notional tax:			
350,000 x 20%		70,000	1/2
Effective rate:			
70,000/675,000		10.370%	1/2
Actual rate:			
10.370% x 30% x 16/40		1.244%	1/2
IHT payable:			
815,000 x 1.244%		£10,139	1/2
*complete quarters from 5 January 2018 (when Lenny turned 18) – 19 January 2022		16	1/2
Total			(4)

5.

	p	£	
1. For IHT purposes we take the lower of the quarter up value and the average of marked bargains:			
Quarter up: $340p + (360p - 340p)/4$	345		1/2
Average of marked bargains: $(338p + 360p)/2$	349		1/2
Therefore, value transferred = 5,000 x 345p		17,250	1
2. For CGT purposes we take the midpoint of the bid and offer prices:			
$(360p - 340p)/2$	350		1/2
Therefore, value of shares transferred = 5,000 x 350p		17,500	1/2
Total			(3)

6.

Lars' Estate chargeable to IHT:	£	
Main residence in Norway plus cash and chattels = excluded property	nil	1/2
Dollars held at London bank = excluded property as Lars NR/ND	nil	1/2
Shares in Bergen plc = UK situs asset as registered in the UK	370,000	1/2
Loan to Robert = UK situs asset due to UK resident debtor	50,000	1/2
Shares in Oslo ASA = excluded property, but the value of the shares attributable to UK situs residential property must be included: £800,000 x £900,000 / £2,500,000	288,000	1/2
Value chargeable to UK IHT	708,000	
Nil rate band	(325,000)	1/2
Taxable estate	383,000	
IHT @ 40%	153,200	1/2
Total		(4)

7.

The value of the shares must be aggregated for the free estate and the QIIP		1/2
Total combined shares held in Invest Ltd = 12,000 = 60%		1/2
Shares in free estate: 9,000 x £56	£504,000	1/2
Shares in QIIP: 3,000 x £56	£168,000	1/2
Total value of shares in estate	£672,000	
Total		(2)

8. No disposal took place for CGT purposes when Eira turned 25 (1/2) as she had an undivided share in the property (1/2). This is in accordance with *Crowe v Appleby*.

Therefore, the capital gain arising when Ben turned 25 is as follows:

Deemed proceeds (MV)	£975,000	1/2
Base cost	(340,000)	1/2
Gain	<u>£635,000</u>	

A claim for s.260 gift relief can be made (1/2) on half of the gain, as only Ben's half of the property will be subject to an IHT exit charge in May 2021 (1/2). Eira's half of the property would have been subject to an IHT exit charge on her 25th birthday in 2018.

Total

(3)

9.

	£	£	
Sale at undervalue to Nova Ltd 23/07/13: £350,000 - £120,000		230,000	1/2
NRB 2013/14	325,000		1/2
CLTs	nil		
		(325,000)	
Taxable transfer		£nil	

Gift to Bead Discretionary Trust 20/09/19:		440,000	
NRB 2019/20:	325,000		
CLTs	<u>230,000</u>		1/2
		(95,000)	
		£345,000	
IHT payable:			
345,000x 25%		<u>£86,250</u>	1/2
IHT on death:			
Gift to Nova Ltd > 7 years prior so no additional tax			1/2
Gift to Bead discretionary trust:			
Gross transfer: 440,000 + 86,250		526,250	1/2
NRB 2021/22	325,000		
Less CTs in 7 years prior:	<u>(230,000)</u>		
		(95,000)	
		£431,250	
IHT @ 40%		172,500	1/2
Lifetime IHT paid		<u>(86,250)</u>	1/2
Additional IHT on death		<u>£86,250</u>	
Total			(4)

10.

	£	
Gift to Tom:		
Painting (MV at gift)	310,000	
Cash	<u>600,000</u>	
	910,000	
Annual exemption 2019/20 & 2018/19	<u>(6,000)</u>	1/2
PET	904,000	
Fall in value relief*: £310,000 - £250,000 =	<u>(60,000)</u>	1
Amount chargeable on Tom	844,000	
Selma's nil rate band	<u>(325,000)</u>	1/2
Taxable on Tom	<u>£519,000</u>	
IHT payable @ 40%	<u>£207,600</u>	1/2
*NB no fall in value relief for gift of cash		1/2
Total		(3)

11. 1) Nadine appears to have met the conditions for the heritage property to remain exempt from HMRC during her ownership of it (1/2). She advertised (1/2) and allowed public access to the statue for at least one month per year throughout her ownership, which is the minimum level considered to be "reasonable access" by HMRC (1/2). The statue was not taken overseas (1/2), and Nadine ensured it was insured and professionally maintained (1/2).
- 2) Scarlett could claim conditional exemption on the failed PET on Nadine's death provided she still owned the statue (1/2), made the claim within two years of receipt of the gift (1/2),

and continued to comply with the undertakings previously given (1/2). Although Nadine hadn't owned the statue herself for the requisite six years prior to her gift to Scarlett (1/2), she had inherited it from her great uncle and it was held to be both conditionally exempt on his death and subsequently as a result of her own undertakings (1/2).

Total

MAX (4)

12. Amelie The borrowed money has been used by a non-UK domiciled individual to purchase excluded property (1/2) and so will be disallowed under s.162A IHTA 1984 and cannot be deducted when calculating the chargeable UK estate (1/2). This is the case even though the debt was incurred before the Finance Act changes in 2013.
- Ben The loan will be deducted against the value of the factory which will qualify for BPR, rather than from his general estate under s.162B IHTA 1984 (1/2). It will be deducted before BPR is given therefore either totally negating or reducing the relief available for the borrowings (1/2).
- Danny As the loan was taken out before 6 April 2013 s.162B IHTA 1984 does not apply (1/2), the loan will be deducted from the value of his rental property rather than the agricultural land (1/2).

Total

(3)



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Part II Suggested Answers

13.

1)

Income Tax Liability:

	Non- Savings £	Savings £	Dividends £	
Bank Interest		100		$\frac{1}{2}$
Dividends			45,000	$\frac{1}{2}$
Total income	NIL	100	45,000	

Income at standard rate

	£	
100 x 20%	20	$\frac{1}{2}$
900 @ 7.5%	68	$\frac{1}{2}$
865 @ 7.5%	65	$\frac{1}{2}$

Income at rate applicable to trusts

43,235 x 38.1%	16,473	$\frac{1}{2}$
Total tax due	<u>16,626</u>	$\frac{1}{2}$

As Joseph's wife benefits from the trust, it is settlor interested, for Income Tax and Capital Gains Tax purposes (1/2). The trustees are initially taxed on the trust income (1/2). Any tax paid by the trustees does not enter the tax pool as it is treated as paid on behalf of the settlor (1/2).

Subtotal (5)

2)

Joseph – R185

	Tax	Net	
Savings Income at basic rate	20	80	$(\frac{1}{2})$
Dividend Income at dividend rate	68	832	$(\frac{1}{2})$
Dividend income at trust rate	16,473	26,762	$(\frac{1}{2})$

The trust income retains its character on attribution to the settlor (1/2). The settlor therefore receives a tax credit equal to the tax actually paid by the trustees (1/2).

Mona & Tom – R185s

Total payments from settlor interested trusts	Net 5,000	$(\frac{1}{2})$
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As the trust is settlor interested, notional tax is treated as paid on distributions to other beneficiaries (1/2) No further tax is therefore due (1/2) but neither is this notional tax repayable (1/2) or available to be offset against other income of those beneficiaries (1/2).

Subtotal (5)

3)

Joseph's Income Tax Liability:

	Non- Savings £	Savings £	Dividends £	
Employment	35,000			1/2
Bank Interest		100		1/2
Dividends			45,000	1/2
Less: Personal Allowance	<u>(12,570)</u>			1/2
	22,430	100	45,000	
Tax Due:			£	
22,430 @ 20%			4,486	1/2
100 @ 0%			0	1/2
2,000 @ 0%			0	1/2
13,170 @ 7.5%			988	1/2
29,830 @ 32.5%			9,695	1/2
Total tax due			£15,169	
Less: Tax Deducted at source			(4,486)	1/2
Less: Tax Credit from Trust			<u>(16,561)</u>	1/2
Total Tax Repayable			<u>(5,878)</u>	1/2

As the repayment relates wholly to trust income (1/2), the tax deducted at source regarding the employment income being correct, this repayment must be passed back to the Trustees (1/2)

Subtotal

Max (6)

Joseph's Capital Gains Tax Liability on transfer of shares into trust:

Transfer Value	500,000	1/2
Less: Cost of Acquisition	<u>(350,000)</u>	1/2
Chargeable Gain	150,000	1/2
Less: Annual exempt amount	<u>(12,300)</u>	1/2
Taxable Gain	137,700	
Tax @ 20% payable 31 January 2023	27,540	1

No holdover relief is available on the transfer of the shares into the trust (1/2), as the trust is settlor interested (1/2).

Payment of the tax may be made by 10 equal annual instalments starting with the normal due date for payment of the Capital Gains Tax (31 January 2023 as above) (1/2) as the following conditions are satisfied:

- 1) A Capital Gains Tax liability arises because of the gift (1/2)
- 2) The settlor cannot claim gift relief (1/2) and
- 3) The asset falls within s.281(3) TCGA 1992 which includes shares in an unlisted company (1/2)

Subtotal

Max (4)

14.

1)

Verity's Nil Rate Band		312,000	½
John's Nil Rate Band			
Nil Rate Band at Date of Death		325,000	½
Verity's Unused Nil Rate Band	312,000		½
Less: Legacy to Nephew	<u>(125,000)</u>		½
	<u>187,000</u>		
% unused	187,000/312,000 = 59.94%	<u>194,805</u>	1½
Total nil rate band		<u>519,805</u>	1
Rachael's Nil Rate Band			
Nil rate band at date of death		325,000	½
John's Unused Nil Rate Band	519,805		½
Less: Gift to Son	<u>(420,000)</u>		½
	<u>99,805</u>		
% unused	99,805/325,000 = 30.71%	<u>99,808</u>	1½
		<u>424,808</u>	1

Subtotal **Max (8)**

2)

Where two individuals own a property as joint tenants, the property is not divided into shares, but each co-owner owns the whole property together with the other co-owner (½). As Rachael owned the rental property as joint tenants with her brother, on her death the whole property continues in the ownership of her brother (½).

Where two individuals own a property as tenants in common, each owner owns an undivided share in the property (½). As Rachael owned the marital home as tenants in common with her spouse, on her death her share of the property passes in accordance with her Will (½).

Subtotal **(2)**

3)

IHT payable on death estate:

	£	
Chargeable Estate	545,000	1
Less: Nil rate band	<u>(424,808)</u>	½
	<u>£120,192</u>	
IHT payable at 40/60	<u>£80,128</u>	½

As the rental property passing to Ralph is a legacy of UK property, it is tax free. Therefore the IHT would be calculated by grossing up at 40/60.

Subtotal **(2)**

4)

Key Components of a Valid Will:

(Any five of the following) (1) each - Max (5)

- A Will must be in writing.
- A Will must be signed by the testator or, in exceptional circumstances, someone else in the testator's presence.
- The testator's signature must be witnessed by two persons who are present together when the testator signs the Will.
- A witness, or a spouse or civil partner of a witness, cannot benefit under the Will.
- The testator must be sui juris, i.e., they must have the capacity to make a Will. This means they must be over 18 and be of sound mind.
- The Will must have been made of the testator's own free will i.e., without coercion
- The testator must intend for their property to be distributed in accordance with the Will

Changing a Will:

(Any three of the following) (1) each - Max (3)

- During lifetime, a testator may change their Will by executing one, or more, codicils to the Will.
- The terms of a Will can be varied after death by a deed of variation within two years of death.
- A Will can be revoked by executing a later Will or codicil which revokes all previous Wills, or specifically revokes a particular previous Will.
- A Will can also be revoked by entering into a marriage or civil partnership, although a Will made in contemplation of marriage is not revoked on the subsequent marriage.
- A Will can be revoked by physical destruction in the testator's presence, providing this destruction is intended to revoke the Will
- A Will can also be revoked by letter, signed by the testator and two witnesses.

Credit will be given for all other reasonable answers

Subtotal

(8)

Total (20)

15.

1)

IHT payable on lifetime gift:

The trust is a qualifying IIP as it was set up on the death of Ahmed (1/2) When Nikita made the transfer of the right to income to her daughter, she became absolutely entitled to the entire trust assets as against the trustees (1/2). This represents a potentially exempt transfer (PET) by Nikita (1/2). No lifetime tax is therefore payable (1/2).

Tax due on death:

Lifetime gift

	£	£	
Failed PET		420,000	1/2
Nil rate band		(325,000)	1/2
		95,000	
IHT payable at 40%		38,000	1/2
Less: Taper relief (4-5 years 40%)		(15,200)	1/2
IHT due		22,800	

Payable by the trustees (primary liability)/Nikita's daughter (limited liability) 1

	£	£	
Estate		547,000	1/2
Nil rate band remaining (325,000-420,000)		(NIL)	1/2
		547,000	
IHT payable at 40%		218,800	1
			1
			Payable by executors of Nikitas estate borne by Nikita's niece

Subtotal (8)

2)

Your firm is not qualified to advise on specific investment products (1/2) and you should therefore recommend that the client seek independent financial advice (1/2). The firm has a duty to disclose details of any commission received from an insurer (1/2). The terms of engagement should specifically set out the way in which any such commission is calculated (1/2)

Subtotal (2)

16.

- 1) Business Asset Disposal Relief (BADR) is available when qualifying business assets (1/2) are disposed of by a qualifying trust (1/2).

There is no minimum shareholding requirement for the trust (1/2).

To be a qualifying trust there must be a permanent interest in possession for at least two years out of the last five years prior to the date of sale (1/2). Both Jason and Edward have a permanent interest in possession in the trust held since its creation in July 2017 (1/2).

Qualifying business assets include shares in a qualifying company (1/2). A qualifying company is a company that is the personal trading company of a beneficiary (in which they have held more than 5% of the shares for at least two out of the last five years) (1/2). Both Jason and Edward qualify as they have held 6% for many years (1/2).

The beneficiary must also have been a full-time working officer or employee of the company for two out of the five years prior to the disposal (1/2). Jason satisfies this condition (1/2). Edward does not. (1/2)

BADR is therefore available to the trust on the disposal of Jason's half of the share sale (1/2).

Investors relief (IR) is available where a qualifying trust has subscribed for shares in an unlisted trading company such as Red Ltd (1/2) and has held these for at least three years (1/2). As the trust subscribed for the shares in April 2018 the trustees satisfy this condition (1/2).

Additional conditions must be met to be classed as a qualifying trust as follows:

There must be a permanent interest in possession held by a beneficiary for at least three years prior to the sale (1/2). Edward and Jason qualify having held their permanent interest in possessions since July 2017 (1/2)

The eligible beneficiary has not been an employee of the company for at least three years prior to the disposal by the trustees. Only Edward satisfies this condition (1/2).

Investors relief is therefore available on one half of the gain representing Edward's half share of the interest in possession (1/2).

Subtotal

Max (8)

- 2) The trustees and the beneficiary must make the claim for relief jointly (1/2) as the beneficiary's BADR/IR lifetime allowance of £1million/£10million respectively is reduced by BADR/IR claimed on gains in an IIP (1/2).

In this instance, as Edward is ineligible to claim IR personally in respect of his holding in Red Ltd (not having subscribed for these) (1/2) it does not provide a direct conflict if the trust claims IR (1/2). However, Edward may have further shareholdings that do qualify for IR, and he may therefore want to preserve his IR lifetime allowance for relief to be available on the sale of these shareholdings in the future (1/2).

Jason is eligible to claim BADR personally in respect of his holding in Red Ltd, so he may wish to preserve his BADR lifetime allowance for a personal sale of his shares (1/2).

Subtotal

Max (2)