THE ASSOCIATION OF TAXATION TECHNICIANS

ATT PAPER 5 INHERITANCE TAX, TRUSTS & ESTATES

May 2023

TIME ALLOWED

3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- A maximum of two marks will be awarded for the quality of presentation in Part II.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

PART I

1. The Longwell Discretionary Trust was created in February 2022 and registered with HMRC in September 2022. The 2021/22 tax return for the trust was issued on 2 December 2022. The trustees submitted the 2021/22 trust tax return and paid the £1,000 Income Tax liability on 2 May 2023.

   1) State the due dates for the submission of the 2021/22 tax return and for the payment of the Income Tax liability.

   2) Explain whether interest and/or penalties are payable calculating these where applicable.

   (3)

2. Nish gifted £75,000 to his daughter Anita in 2011. In October 2022 Anita used the £75,000 to purchase a painting for Nish to hang in his dining room.

   Daisy no longer needed her large family home, so she sold it for £800,000 in June 2022. She gifted the proceeds to her daughter who immediately used the cash to purchase a house for Daisy and her to live in together. Daisy pays for any food she consumes but does not pay rent to her daughter. The annual rent is £24,000.

   Sheila gifted £35,000 to her neighbour Rosie in August 2022. Rosie then purchased a sports car for £100,000 and allowed Sheila to regularly use it whenever she liked.

   Cosmo owned a holiday cottage in Cornwall which he gave to his grandchild. Cosmo continued to use the cottage for holidays regularly.

   Explain whether the Pre-Owned Assets Tax rules apply in each of these scenarios. Calculate the Income Tax charge where applicable. (4)

3. Aisling died on 1 March 2023 having made the following lifetime gifts on which she paid any tax arising:

		£
6 April annually	Gifts to use her annual exemption	3,000
2 April 2019	Studio to her daughter Bella	400,000
14 May 2021	Cash to Upside Ltd	350,000

   Aisling purchased the studio in 2010 and it had been used by the Create partnership since. Both Aisling and Bella were partners of this trading partnership. At the time of Aisling's death, the studio was valued at £320,000 and was still owned by Bella. Bella remained a partner in the Create partnership which still used the studio.

   Upside Ltd is a manufacturing company owned 100% by Aisling's son.

   Calculate, with explanations, the Inheritance Tax payable as a result of Aisling's death on her lifetime transfers. Assume any available reliefs are claimed. (4)

4. Ivo, who never married and who was always UK domiciled, died on 29 July 2022 having made no lifetime transfers. His estate consisted of the following assets and liabilities:

	£
Main residence in UK	510,000
Holiday home in Utopia	200,000
Chattels and cash	150,000
Capital Gains Tax due but not yet paid	15,000
Utopian death tax payable on holiday home	50,000
Funeral expenses	9,000
Cost of obtaining probate on UK assets	8,000
Additional cost of obtaining probate in Utopia on Utopian property	15,000

Ivo left his entire estate to his friend, Tim.

Calculate, with explanations, the Inheritance Tax payable as a result of Ivo's death. (4)

5. Rachel's spouse died in 2009 and left her an estate worth £750,000. In January 2023 she moved into a care home leaving her main residence, valued at £1.6 million, empty. Her only other asset was £100,000 held in a bank account. She considered the following options:

1) Gifting the house to her son immediately.

2) Leaving the house to either:

   a) a life interest trust; or a discretionary trust.
   b) for the benefit of her two grandchildren in her Will.

3) Selling the house and leaving the proceeds to her daughter in her Will.

Explain how much Residence Nil Rate Band is available, on Rachel's death within three years of moving into the care home, in each of the scenarios above. (4)

6. The trustees of the Widdicombe Life Interest Settlement own an investment property which generates annual rental income. On 6 April 2020 the trustees arranged for the net rents received from the agent to be transferred immediately to the life tenant's bank account. They mistakenly believed they had mandated this income to the life tenant who would declare the income on his own tax return. The life tenant did not declare the rental income on his tax return.

The trustees submitted the trust's 2020/21 tax return to HMRC on 10 January 2022. In December 2022 HMRC opened an enquiry into the tax return due to the decrease in rental income reported.

1) State, with explanations, the appropriate level of penalty and the minimum and maximum level of penalty to which HMRC could subject the trustees.

2) Explain the circumstances in which any penalty imposed could be suspended.

3) Explain the ethical implications for a member of the ATT when client information is requested by HMRC in relation to the enquiry.

(4)

7. Iwi died on Sunday 25 September 2022 owning 30,000 shares in Invest plc.

The stock exchange official share prices were as follows:

	Closing Bid Price	Closing Offer Price	Marked bargains
23 September 2022	546p	584p	544p, 556p, 584p
26 September 2022	514p	550p	517p, 530p, 549p

Calculate, with explanations, the value of the shares in Iwi's death estate for Inheritance Tax purposes. (4)

8. Mae is the settlor of the Ritchie Discretionary Trust, the only trust she has created. The trustees made the following sales in 2022/23:

		Purchase cost	Proceeds
		£	£
4 June 2022	Sale of sculpture to Mae	25,000	30,000
13 July 2022	Sale of painting to Mae	85,000	70,000
20 March 2023	Sale of quoted shares	18,000	46,000

The trustees obtained professional valuations of the two assets sold to Mae to ensure that they were sold at market value.

Calculate, with explanations, the Capital Gains Tax payable by the trustees for the year ended 6 April 2023. (3)

9. The trustees of the Sparkling Trust have recently become your clients. You have found out that they failed to declare high levels of foreign dividends on the trust tax return for the three tax years before you became their adviser.

The trustees will not authorise you to make a disclosure of this income to HMRC. You have explained what could happen if they do not make a disclosure both verbally and in writing on a number of occasions.

Explain what your next steps should be as a member of the ATT. (2)

10. Rosa was born in the UK in 1995. Her parents were domiciled in Italy at the time of her birth and returned to Italy in 1997 for Rosa to attend school. Rosa's parents moved back to the UK in May 2006 for work purposes, with Rosa. Rosa and her family always planned to move back to Italy permanently once Rosa's parents retire. They have not yet retired.

On 5 April 2019 Rosa created the Sneddon Discretionary Trust. She settled non-UK situs assets only. She elected two family friends who were resident and domiciled in the UK to be the trustees making it a UK resident trust.

Rosa died on 19 October 2022 while she still lived in the UK.

1) Explain Rosa's domicile position throughout her life.

2) Explain how the assets of the Sneddon Discretionary Trust should be treated for Inheritance Tax purposes on Rosa's death.

(4)

11. James died on 28 September 2022. In his Will he left a specific gift of gold cufflinks to his friend Ed. Ed does not like the cufflinks and would prefer not to receive the gift.

Explain the two options available to Ed if he does not want to accept the gift. (2)

12. Sally created the Keyworth Discretionary Trust in 2010. The trustees sold a painting on 30 May 2022 making a capital gain of £30,000.

The trustees also appointed a flat to a beneficiary on 8 July 2022 at a capital loss of £(50,000).

On 1 September 2022 the trustees sold a statue making a capital gain of £40,000.

Calculate, with explanations, the trustees' net gains before annual exempt amount for 2022/23 including how the capital loss on the flat is relieved. (2)

PART II

Presentation skills – awarded for quality of presentation. (2 marks)

13. Subbu died on 6 April 2021. His Will left his entire estate to his son, Kumar and daughter, Noreen in equal shares.

On 6 January 2022, Kumar prepared a deed of variation to redirect his share of the estate to his 15-year-old daughter, Riya. We do not yet know which statements were made within the deed.

The total income available for distribution within the estate, after being taxed at the standard 20% rate, was as follows:

	£
2021/22	24,000
2022/23	16,000

A distribution of £5,000 was made to Kumar on 5 October 2021, and on 5 April 2022 Riya received a distribution of £2,000.

The administration period for the estate ended on 5 April 2023.

Requirements:

1) **Explain how the deed of variation affects the Income Tax and Capital Gains Tax position of the beneficiaries.** (5)

2) **Provide any R185 entries for Kumar and Riya, clearly showing to whom each R185 relates.** (4)

3) **Explain what the effect would be if Riya sold her share of any chargeable assets whilst she was still a minor.** (1)

Total (10)

14. Rachel, a UK resident and domiciled individual, died on 5 May 2022, leaving the following Estate:

Probate Value

	£
Main residence	710,000
Rental property	440,000
Shares in RL Property Ltd	1,800,000
War medals	42,000
Quoted share portfolio	450,000
Cash at bank	218,000
Personal chattels	4,000

Rachel's Will states that the main residence, rental property, and personal chattels are left to her husband and her remaining estate is distributable in equal parts to her son and daughter. Rachel had made no lifetime gifts.

Rachel owned an extensive collection of war medals, which she had been awarded in connection with her time in the UK Armed Forces.

RL Property Ltd, is an unquoted investment company set up by Rachel many years ago to hold most of her investment properties. She owned 100% of the share capital.

The share portfolio consists of a number of different shareholdings, all of which are less than 1% of the share capital of each company.

Her executors have identified the following debts within Rachel's estate:

	£
Mortgage secured against the rental property	100,000
Unsecured personal loan	40,000
21/22 Income Tax liability	32,000
Funeral Expenses	5,000

The executors would like to pay any Inheritance Tax due in instalments where possible.

The executors are due to file the IHT400 at the end of May 2023 and make payment of the non-instalment tax due in order that they can apply for probate. They then intend to bring their account up to date by making payment of any instalments outstanding (including interest) by 31 December 2023.

Requirements:

1) **Calculate, with explanations, the Inheritance Tax due on Rachel's estate. State the due date(s) for payment, assuming that the executors pay in instalments where possible.** (14)

2) **Calculate the interest due on the late payment of the Inheritance Tax, advising the executors how much to pay on each date.** (5)

3) **Explain how the sale of the assets eligible for instalments in July 2023 would affect the due dates of payment of the Inheritance Tax.** (1)

Total (20)

15. Mr Drake died on 31 December 2020, leaving behind a 12-year-old son, Rupert. Mr Drake was unmarried and did not have a valid Will in place, and so his Estate passed under the intestacy rules into trust for Rupert until he reached majority.

In 2022/23, the Trust had the following income:

	£
Bank interest	1,300
UK company dividends	8,200
Net rental income	16,800

The tax pool bought forward as of 6 April 2022 was £4,700.

On 8 May 2022, the trustees distributed £20,000 to Rupert's legal guardian, to be used towards Rupert's maintenance.

The trustees are your client. They do not fully understand the tax implications of the trust but think that it may qualify for favourable Income Tax and Capital Gains Tax treatment.

Requirements:

Write a letter to the Trustees, in which you:

1) **Explain what kind of trust exists and the claims and/or elections by the trustees that can be made to improve the Income Tax position of the trust. Explain the mechanism for such claims and/or elections including any applicable time limits.** (4)

2) **Provide a calculation of the 2022/23 Income Tax payable on the trust income. Assume any relevant election has been made and state the entries on form R185 for Rupert.** (4)

3) **Explain Rupert's likely tax position for 2022/23 on the basis he has no other income. Calculations are not required.** (2)

Total (10)

16. The Verdy Discretionary Trust was created by Mr Verdy on 30 November 2016, for the benefit of his children, Jake and Holly. On the creation of the Trust, Mr Verdy made a claim to holdover any gains on the transfer of assets into the trust.

Mr Verdy had previously created another trust, for the benefit of his niece and nephew on 31 January 2013, by settling a property valued at £175,000, and gifted a share portfolio to his daughter on 31 March 2016, valued at £50,000. Mr Vardy makes gifts to utilise his annual exemption on 6 April each year.

The assets of the Verdy Discretionary Trust are as follows:

	Initial value	Value at 1 December 2022
	£	£
Residential property	300,000	425,000
Quoted shares	200,000	220,000
Cash	50,000	30,000

The residential property has been Jake's main residence since it was transferred into the trust, so the trustees have decided to transfer the property out of trust to Jake absolutely on 1 December 2022. Jake agreed to pay any Inheritance Tax due. No other disposals or transfers took place in 2022/23.

The residential property was initially purchased by Mr Verdy in 2010 for £100,000.

When valuing the property for the purposes of the above transaction, it was clear that the property was in a state of disrepair, which was substantially impairing the value. The trustees had allowed the house insurance to lapse, and a water pipe had burst causing significant damage.

You have an engagement with the trustees to provide tax advice to the trust.

Requirements:

1) Calculate the Inheritance Tax charge on the transfer of the residential property out of the trust. (5)

2) Calculate the Capital Gains Tax due on the transfer of the property out of the trust assuming no claims are made on the transfer. Explain the effect of any potential reliefs that may be available. (5)

3) Explain the ethical considerations if Jake asked you to consider his tax position as part of your work on the above transactions. (2)

4) Explain the legal implications of the property being allowed to fall into a state of disrepair by the trustees, any remedies available for Jake and Holly as beneficiaries of the trust, and how they could remove the current trustees. (6)

Total (18)