



# **May 2023 Examination**

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## **PAPER 5**

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### **Inheritance Tax, Trusts & Estates**

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Part I Suggested Answers

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1. The 2021/22 tax return and tax payment were due on the later of:

- i) 31 January 2023; or
- ii) three months after the tax return was issued.

The due date for the tax return submission and payment was therefore 2 March 2023, which is three months after the tax return was issued (1/2).

The initial penalty of £100 for late submission of the tax return will apply as it was less than three months late (1/2).

As the Income Tax was paid more than 30 days late, a penalty of £50 will apply (5% x £1,000) (1/2).

Interest will also be applied to the late paid tax as follows:

$$£1,000 \times 3.5\% \times 2/12 = £6 \text{ (1)}$$

**Total** (3)

2. The Pre-Owned Asset Tax (POAT) rules would not apply to Nish's scenario as he gifted the cash to Anita more than seven years before she purchased the painting (1/2). This is therefore an excluded transaction (1/2).

The POAT rules would apply to Daisy's gift as she continues to benefit from the cash that she gave away by living rent-free in a house which has been purchased with that cash within seven years of the gift (1/2). The Income Tax charge is based on the full rental value as she has use of the entire property i.e., £24,000 (1/2).

The POAT rules would apply to the gift made by Sheila, as although she only funded part of the purchase of the car she continues to benefit from the use of the car (1/2). The Income Tax charge is pro-rated i.e., £100,000 x 2% x £35,000/£100,000 = £700 (1/2). However, no Income Tax liability will arise as the charge will fall within the £5,000 de minimis limit (1/2).

The POAT rules would not apply to Cosmo because this gift will instead be caught by the Gift With Reservation of Benefit rules (1/2)

**Total** (4)

3.

	£	£	
Tax during lifetime:			
02/04/2019 Gift of Studio	400,000		
BPR @ 50%	(200,000)		1/2
Annual exemptions (AE) already used	-		
PET		<u>200,000</u>	
14/05/2021 Gift of cash	350,000		
AEs already used	-		
Chargeable lifetime transfer (CLT)		350,000	
Nil rate band (NRB) 2021/22	325,000		
CLTs in previous seven years	-		
NRB available		<u>(325,000)</u>	1/2
Taxable transfer		<u>25,000</u>	
IHT @ 25% (settlor pays)		<u>6,250</u>	1/2
Death tax on lifetime transfers:			

02/04/2019 failed PET		200,000	
Fall in value relief:			
£400,000 - £320,000 =	80,000		1/2
Less equivalent reduction for BPR @ 50%	(40,000)		1/2
Relief given		(40,000)	
		160,000	
NRB 2022/23		(325,000)	1/2
Taxable transfer		-	
14/05/2021 Gross CLT (350,000 + 6,250)		356,250	
NRB 2022/23	325,000		
Less settlor's cumulative total*	(200,000)		1/2
Available NRB		(125,000)	
Taxable transfer		231,250	
IHT at 40%		92,500	1/2
Less lifetime IHT paid		(6,250)	1/2
IHT payable		86,250	
*after deduction of BPR but before fall in value relief			
<b>Total</b>		<b>MAX</b>	<b>(4)</b>

4.

		£	£	
Death estate:				
Main residence in UK		510,000		
Holiday home in Utopia	200,000			
Less : Cost of obtaining probate in Utopia:				
Restricted to £200,000 x 5%	(10,000)			1/2
Net value		190,000		
Chattels and cash		150,000		
			850,000	
Liabilities:				
Capital Gains Tax		15,000		1/2
Funeral expenses – reasonable		9,000		1/2
Cost of obtaining probate in the UK – not allowable		-		1/2
			(24,000)	
Chargeable estate			826,000	
Nil rate band			(325,000)	1/2
Taxable estate			501,000	
IHT @ 40%			200,400	1/2
Double tax relief will be the lower of:				
i) Overseas tax suffered on Utopian property		50,000		
ii) UK tax charged on Utopian property: £200,400/£826,000 x £190,000		46,097		
DTR:			(46,097)	1
IHT payable			£154,303	
<b>Total</b>				<b>(4)</b>

5. 1) Nil Residence Nil Rate Band (RNRB) would not be available in this scenario (1/2) as although the property passes to a direct lineal descendant (Rachel's son), the allowance is only available against the death estate not against a lifetime transfer chargeable on death (1/2).
- 2) a) The RNRB would be available if the house was left via Will to a life interest trust for the benefit of Rachel's grandchildren and their spouses, being direct lineal descendants, as this is an immediate post death interest (1/2). As Rachel was widowed before 6 April 2017 the brought forward allowance would also be available giving a total allowance of £350,000 (1/2)
- b) If the residence was left to a discretionary trust for the benefit of the same beneficiaries' nil allowance would be available (1/2) as they have no immediate right to the assets which remain in the hands of the trustees and are only available at their discretion (1/2).
- 3) Rachel's estate would qualify for the full downsizing addition (1/2) as she would have sold a qualifying residence after 8 July 2015 with the entire proceeds passing to her daughter, a direct lineal descendant, on her subsequent death (1/2). As Rachel was widowed before 6 April 2017 the brought forward allowance increases the available downsizing addition given to £350,000 (1/2).

Total

Max (4)

6. 1) It is likely that due to the trustees' belief that the rental income was being reported by the life tenant, the omission would be viewed as failure to take reasonable care when completing the tax return, rather than as deliberate, or deliberate and concealed (1/2).  
  
On this basis, as the disclosure was prompted by the enquiry (1/2), the minimum penalty would be 15% (1/2) and the maximum penalty would be 30% (1/2) of the potential lost revenue.
- 2) As the omission was careless, the penalty could be suspended for up to two years (1/2), subject to the agreement of the suspension conditions with HMRC and adherence to the same for the period agreed (1/2).
- 3) The member should first check in the client's engagement letter to see whether it includes permission to disclose information to HMRC (1/2). If there is no permission in the engagement letter, the member should obtain permission directly from the client (1/2). In certain circumstances there is a legal duty to disclose information on the receipt of a valid statutory request from HMRC so no permission would be required from the client in this instance (1/2).

Total

Max (4)

7. As Iwi died on a Sunday, which is a non-business day, we could choose to use the value on either Friday 23 September or Monday 26 September (1/2), whichever gives the best result. The prices on Monday 26 September are lower so we would therefore use the Monday 26 September value (1/2).

Firstly, the shares are valued using the "quarter up" method:

$(550p - 514p)$	+ 514p =	523p	1
4			

Next the shares are valued using the "average of marked bargains" method:

$(517p + 549p)$	=	533p	1
2			

The lower of the two values is used, i.e., 523p (1/2)

The value for IHT purposes is therefore:

$$523p \times 30,000 = \text{£}156,900 \text{ (1/2)}$$

Total

(4)

8.

	£	£	
04.06.22 Sale of sculpture:			
Proceeds (MV)	30,000		
Cost	(25,000)		
Capital gain		5,000	½
13.07.22 Sale of painting:			
Proceeds (MV)	70,000		
Cost	(85,000)		
Capital loss	(15,000)		½
Capital loss set against gain on sale of sculpture		(£5,000)	
Unused capital loss to be carried forward*	(10,000)		
20.03.2033 Sale of quoted shares:			
Proceeds	46,000		
Cost	(18,000)		
Capital gain		28,000	½
Total gains for the year		28,000	
Annual exempt amount		(6,150)	½
Taxable gains		21,850	
CGT @ 20%		4,370	½
*As Mae is connected to the trustees, the loss can only be used against gains on disposal of assets to Mae in the same and future tax years			½
<b>Total</b>			<b>(3)</b>

9. The member must cease to act for the trustees if they will not authorise the disclosure of the income to HMRC (1/2). The member must then notify HMRC that they have ceased to act (1/2).

The member must also consider whether they are required to make a suspicious activity report to their Money Laundering Reporting Officer (MLRO) (1/2) or to the National Crime Agency if they are the MLRO (1/2). They need to be very careful to ensure they avoid committing the offence of tipping off and should not mention to the trustees that they have made a suspicious activity report (1/2).

When responding to a professional clearance request, the member must advise that they concluded that continuing their relationship was not compatible with their professional obligations and allow the new adviser to draw their own conclusions on this point (1/2).

Total

MAX (2)

10. 1) Although Rosa was born in the UK (1/2) she had a domicile of origin in Italy as her parents were domiciled in Italy at the time of her birth (1/2). As Rosa and her parents always intended to return to Italy, she did not obtain a domicile of dependency (1/2) or choice (1/2) in the UK.

Rosa did, however, become deemed domiciled in the UK on 6 April 2021 (1/2) when she had been UK resident for 15 of the preceding 20 tax years (1/2), including at least one of the four tax years ending in 2021/22 (1/2).

- 2) As the Sneddon Discretionary Trust was created when Rosa was not domiciled (or deemed domiciled) in the UK, it is an excluded property trust (1/2). Despite Rosa being deemed domiciled in the UK at the time of her death, non-UK situs assets of the trust remain excluded property and are not subject to UK IHT (1/2). The fact that the trust is UK resident is irrelevant for IHT purposes (1/2).

**Total** **MAX (4)**

11. If Ed does not want to accept the gift, he could make a formal disclaimer (1/2). This would mean that the cufflinks would pass to the person entitled to the residue of the estate as though the legacy had simply failed (1/2).

Alternatively, if Ed would prefer for the cufflinks to be passed to a specific individual, he could use a Deed of Variation (1/2). This would enable Ed to stipulate the new recipient within the deed (1/2).

**Total** **(2)**

12.

1)	£	£	
30.05.22 Gain on sale of painting:		30,000	
08.07.22 Distribution of flat:	(50,000)		
Capital loss(restricted)*	30,000	(30,000)	½
Excess capital loss c/f against beneficiary's gains^	<u>20,000</u>		½
Capital loss c/f for future use of trustees^	0		
01.09.22 Gain on sale of statue:		<u>40,000</u>	
Taxable gains for the year		<u>40,000</u>	½
*The first £30,000 of the loss is set against pre-entitlement gains i.e., the sale of the painting.			½
^The excess capital loss of £20,000 cannot be used by the trustees against future gains but will instead be treated as a loss of the beneficiary who can set it only against a gain made on a future disposal of the flat.			½ ½
<b>Total</b>		<b>MAX</b>	<b>(2)</b>



## **May 2023 Examination**

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### **PAPER 5**

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### **Inheritance Tax, Trusts & Estates**

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Part II Suggested Answers

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13.

1)

A deed of variation cannot apply retrospectively for Income Tax purposes (1/2).

As Kumar received a distribution before he made the variation, this will be taxed on him as income at the date of receipt (1/2).

The balance of the income will also be taxed on Kumar as he has made a parental settlement for Income Tax purposes because Riya is a minor at the date of the deed of variation (1/2).

The distribution to Riya will therefore be taxed on Kumar at the date of receipt (1/2) and the balance of Riya's share of the income will be taxed on Kumar at the end of the administration period (1/2).

If the deed of variation contains a statement of intent that the rules of s.62 TCGA 1992 apply (1/2), then, for Capital Gains Tax purposes, the assets are treated as being distributed directly from the deceased's estate to the new beneficiary (1/2). The CGT base cost for Riya would therefore be the probate value (1/2) of the assets.

If the statement is not included then the deed of variation is treated as a chargeable disposal by Kumar as the original beneficiary with a base cost equal to the probate value (1/2). The CGT base cost for Riya would then be the asset value at the date of the deed of variation (1/2).

**Subtotal** (5)

2)

**R185 form for 2021/22**

R185 – Kumar ½

Net income distribution	7,000	1/2
Tax Credit	1,750	1

**R185 form for 2022/23**

R185 – Kumar ½

Net Income Distribution	13,000	½
Tax Credit	3,250	1

No R185 is required for Riya (1/2).

**Subtotal** Max (4)

3)

The deed of variation is not a parental settlement for CGT purposes (1/2), and the gain on the disposal of the assets will therefore be taxed on Riya (1/2).

**Subtotal** (1)

**Total (10)**



## 14.

1)

	Qualifying Property for Instalment Option		Non-qualifying property for Instalment Option		
	£	£	£	£	
Main residence		710,000			1/2
Rental Property	440,000				1/2
Less: Mortgage	<u>(100,000)</u>				1/2
		340,000			
Cash			218,000		1/2
Personal Chattels			4,000		1/2
Quoted Shares			450,000		1/2
Shares in RL Property Ltd		1,800,000			1/2
War Medals				NIL	1/2
		<u>2,850,000</u>		<u>672,000</u>	
Less: Liabilities					
Unsecured Personal Loan			40,000		1
21/22 Income Tax Liability			32,000		
Funeral Expenses			<u>5,000</u>		
			(77,000)		
Less: Spousal Exemption		(1,050,000)	(4,000)		1/2
Nil rate band		<u>(244,667)</u>	<u>(80,333)</u>		1
		£1,555,333	£510,667		
Tax payable at 40%		£622,133	£204,267		1

The liabilities are legally enforceable, and therefore are all deductible from the estate (1/2). As the mortgage is secured against the rental property, it reduces the value of this property, despite the fact that this is an exempt transfer (1/2). As the personal loan is unsecured, it is treated as a general deduction against the chargeable estate and is not deducted from the value of a specific asset (1/2). The general liabilities are deducted from property that does not qualify for the instalment option in priority (1/2).

No BPR is available on the shares in RL Property Ltd, as it is not a trading company (1/2).

War Medals awarded in relation to services with the UK Armed Forces are excluded property, and therefore not subject to Inheritance Tax (1/2).

The nil rate band is apportioned between the instalment and non-instalment property (1/2).

No residence nil rate band is available as the estate is worth more than £2.35 million and the residence is left to Rachel's husband not to lineal descendants (1/2).

The shares in RL Property Ltd qualify for the instalment option under s. 228(1) (a) as Rachel had control of the company on death, i.e., she owns more than 50% of the voting rights.

The quoted shares do not qualify for the instalment option under s.228(1)(a)(b) or (d) IHTA 1984 as they are quoted shares with no controlling interest. (1/2)

A hardship claim under s.228(1)(c) IHTA 1984 should therefore be considered (1/2) however, given the cash available in the estate it is unlikely to be granted by HMRC (1/2) instead the executors can apply for direct payment to be made from the bank accounts (1/2).

Payment of the tax on the non-qualifying property (£204,267) is due on the earlier of six months from the end of the month of death, i.e., 30 November 2022 and delivery of the IHT return (1/2).

The tax due on the property qualifying for the instalment option will be due in 10 equal instalments (1/2). The first payment of £62,213 will be due on 30 November 2022 (1/2), and each subsequent instalment will be paid annually after this (1/2).

**Subtotal** (Max 14)

2)

Tax due in relation to the property that does not qualify for the instalment option is due 30 November 2022, so will be six months late (1/2). Interest is charged from the due date to the date of payment at a current rate of 3.5% (1/2).

Interest is therefore calculated as follows:

$$£204,267 \times 3.5\% \times 6/12 \qquad \qquad \qquad £3,575 \quad \frac{1}{2}$$

Total payable 31 May 2023 is £207,842 (1/2)

The instalments paid by the estate are “interest-bearing” as they do not relate to land qualifying for APR, shares in trading companies, or a business share (1/2). Two instalments are overdue, one by 13 months (due 30 November 2022) and the other by one month (due 30 November 2023) (1/2).

Interest is calculated as follows:

Instalment 1			
£62,213 x 3.5% x 13/12		£2,359	$\frac{1}{2}$
(from instalment due date to date of payment)			
Instalment 2			
£62,213 x 3.5% x 1/12		£181	$\frac{1}{2}$
(from instalment due date to date of payment)			
(£622,133 x 90%) x 3.5%		£19,598	$\frac{1}{2}$
(On amount outstanding from last due date to instalment due date)			
Total		£22,138	

Total payable 31 December 2023 is £62,213 + £62,213 + £22,138 = £146,564 (1/2).

**Subtotal** (5)

3)

If the assets qualifying for the instalment option are sold whilst the IHT is still outstanding the balance of IHT due on the assets becomes payable in full at the point of sale (1).

**Subtotal** (1)

**Total (20)**

15.

Firm A  
100 High Street  
Town B  
AA11 2BB

May 2023

Dear Trustees

**Trust Tax Affairs**

- 1) As Mr. Drake had no valid Will on his death, a statutory trust was created under the intestacy rules (1/2). As the beneficiary of the Trust is Rupert, who is a relevant minor having at least one deceased parent (1/2) and being under the age of 18 (1/2), the trust is a Bereaved Minors Trust (1/2).

The trustees could complete a vulnerable person's election (VPE) (1/2) as the trust fund is applied solely for the benefit of Rupert (1/2), who is a relevant minor and will be absolutely entitled to the capital of the trust at age 18 (1/2).

The VPE is a joint election made by the trustees and Rupert's legal guardian (1/2). The election must be made by 31 January after the end of the tax year following that in which the election first takes place (1/2).

A separate claim allowing the trust to benefit from the special tax treatment afforded by the VPE must be made each year by the trustees on the trust's self-assessment tax return (1/2).

Subtotal Max (4)

- 2) The trust tax liability for the year ended 5 April 2023, assuming that both a VPE and claim for special treatment to apply have been made, is as follows:

	Non- savings £	Savings £	Dividends £	
Rental Income	16,800			
Interest		1,300		
Dividends			8,200	
Less: Personal Allowance	(12,570)			
<b>Taxable Income</b>	<u>4,230</u>	<u>1,300</u>	<u>8,200</u>	1/2
<b>Tax</b>				
770 @ 0% (starting rate band)		NIL		
2,000 @ 0% (dividend allowance)		NIL		
530 @ 0% (savings allowance)		NIL		
4,230 @ 20%		846		1
6,200 @ 8.75%		543		
Income Tax liability		1,389		

<b>Tax Pool</b>	£	
b/fwd	4,700	
Tax paid in 2022/23	1,389	
Tax on distribution	(16,363)	
Additional tax due	10,274	1½
c/fwd	NIL	
Total tax due by trust	£11,663	1/2

<b>R185</b>	Net	Tax	
	£	£	
	20,000	16,363	1/2

Subtotal (4)

- 3) As Rupert has no other income, he is a basic rate taxpayer (1/2). He will be subject to tax at 20% on the gross trust distribution of £36,363 (1/2) after deduction of his personal allowance (1/2). He can offset the 45% tax credit paid by the trust against his tax liability (1/2) resulting in a tax refund (1/2),

Subtotal Max (2)

Total (10)

16.

1) Exit Charge:

	£	£	
Value of trust Fund		550,000	1
Less:			
Current Nil Rate Band	325,000		½
Settlors cumulative chargeable transfers	<u>(175,000)</u>		½
Remaining nil rate band available		<u>(150,000)</u>	
		400,000	
Notional Tax (£400,000 x 20%)		80,000	½
Effective Tax Rate (£80,000 / £550,000)		14.545%	½
Actual Tax Rate (14.545% x 30% x 24/40)		2.618%	1
Tax Due			
£425,000 x 2.618%		£11,127	1

**Subtotal** (5)

2) Capital Gains Tax Due:

	£	£	
Market Value on transfer		425,000	½
Less:			
Value at transfer into trust	300,000		½
Holdover relief under s.260 TCGA 1992	<u>(200,000)</u>		½
		<u>(100,000)</u>	
		325,000	
Less: Annual exempt amount		<u>(3,075)</u>	½
Taxable gain		321,925	
Tax @ 28%		£90,139	½

Private Residence Relief (PRR) is not available as holdover relief was claimed on the transfer of the property into the trust (1/2).

Holdover relief could be claimed on the transfer of the property out of trust (1/2), as there is an immediate charge to IHT on the transfer (1/2). This would be a joint claim by Jake and the trustees (1/2). If the relief were claimed then Jake would not be able to claim PRR on any future gain if he were to sell the property (1/2). The due date for the holdover claim would be four years following the end of the tax year of disposal, i.e. 5 April 2027 (1/2).

**Subtotal** Max (5)

- 3) If Jake asked us to consider his personal tax position as part of our work, we should consider the following: (1/2 mark for each, credit will be given for all reasonable suggestions)
- Who are we engaged to work for?
  - Do we need to issue a separate engagement letter to undertake work for the beneficiaries?
  - Do we need to issue a separate fee agreement for this work?
  - Are we meeting our confidentiality agreements, or should we request permission from Jake and the trustees to share information between them?

Subtotal

Max (2)

- 4) The duties of the trustees include the requirement to maintain and insure trust property to a suitable standard (1/2).

The trustees are personally liable for any loss arising from a breach of trust e.g., by failing to carry out their duties properly (1/2).

There are two remedies available to beneficiaries being

- a) recovery of property (1/2) and
- b) a claim for damages from the trustees (1/2)

If Jake receives the property in its current state, Jake would be entitled to sue the trustees for damages for the cost he incurs in repairing the property (1/2)

If the trustees meet the costs of repairs from the trust fund before transferring the property to Jake, the beneficiaries as a whole could sue the trustees for damages for the unnecessary expense incurred (1/2).

The trust deed may give Mr. Verdy, as settlor, express powers of appointment (1/2), or otherwise nominate a protector to do so (1/2).

Where there is no person expressly nominated by the trust deed (1/2), then the beneficiaries themselves have statutory powers to appoint new trustees (1/2) unless expressly excluded from doing so by the trust deed (1/2). All of the beneficiaries must be of full capacity, together entitled to 100% of the trust and all agree with the appointment (1).

The final recourse is to the statutory powers provided to the courts (1/2).

Subtotal

Max (6)

Total (18)