



November 2023 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part I Suggested Answers

1. The beneficiary of the Trust is Mr. Vaughn's son, Jason, who qualifies as a Disabled Person (DP), so the trust is a Disabled Persons' Trust (1/2).

The trustees could complete a vulnerable person's election (VPE), as the trust fund is applied solely for the benefit of Jason (1/2). This claim is a joint election made by the trustees and the beneficiary's legal representative (1/2). The claim must be made by 31 January following the first year in which the election is in force, i.e., 31 January 2024 (1/2).

The trustees would then be able to elect for special tax treatment to apply for Capital Gains Tax (CGT) purposes for the year of sale (1/2), so that Jason's annual allowance of £12,300 (1/2) could be deducted from the gain instead of the trust annual allowance of (£6,150), and the remaining gain would be subject to CGT at Jason's marginal rate of CGT i.e., either 10/18% or 20/28% (1/2), rather than the rate applicable to trusts of 20/28%. The claim should be made on the trust tax return for the year of sale (1/2).

Total (4)

2. As Jessica's estate has a value of over £2million, the residence nil rate band available would be tapered as follows:

	£	
Estate value over £2million	240,000	
50% restriction	120,000	(1/2)
Nil rate band in 2022/23	175,000	(1/2)
Less: Restriction	<u>(120,000)</u>	
Jessica's Nil Rate Band available	<u>55,000</u>	

Despite the fact Paul died before the introduction of the residence nil rate band, Jessica is still entitled to the transferable nil rate band. Paul's estate was less than £2million and Jessica therefore has a transferable nil rate band available of £175,000. (1/2)

The total residence nil rate band available to utilise against Jessica's estate is therefore increased to £230,000 (£175,000 + £55,000). (1/2)

Total (2)

3. Determinations can be raised by HMRC up to 3 years after the due date of a return (1/2) so all three determinations are valid (1/2). Determinations can be replaced by a Self-Assessment Tax Return within the same time frame, or within 1 year of the date of the determination whichever is later (1/2). So the Trustees are unable to submit Self-Assessment Tax Returns for 2017/18 or 2018/19 (1/2). They can still submit a self-assessment tax return for 2019/20 and have until 31 January 2024 to do so (1/2).

The trustees can make a claim for "special relief" under Sch 1AB TMS 1970 for 2017/18 and 2018/19 (1/2) outside of the normal time limit of 4 years from the end of the relevant tax year i.e., 5 April 2022 and 5 April 2023 respectively (1/2) if the following conditions are met:

- 1) The determinations have assessed tax that is not due (1/2)
- 2) HMRC believe it would be unconscionable to seek to recover the excess tax (1/2)
- 3) The Trustees tax affairs have been brought up to date (1/2) and
- 4) The Trustees have not previously sought special relief (1/2).

Max (4)

4.

1)

	£
Market Value	350,000
Cost	<u>(250,000)</u>
Gain before relief	<u>100,000</u>

Under s71, for Capital Gains Tax purposes, the market value rule applies. (1/2).

For Inheritance Tax purposes the transfer of the property is a PET between Mr Borne and his son. As there is no immediate charge to Inheritance Tax, gift relief is not available under s. 260 IHTA 1992 (1/2)

As the assets being sold are shares in an unquoted trading company, holdover relief will be available under s.165 IHTA 1992 restricted to the amount of undervalue i.e., £50,000 (1/2)

The relief will be further restricted by any non-business assets held within the company, as follows:

$$510,000 / (150,000 + 510,000) = 77.22\% \times £50,000 = £38,636 \text{ (1/2)}$$

The Chargeable gain before annual exempt amount is therefore £100,000 - £38,636 = £61,364 (1/2)

Max (2)

2)

Trustees have a fiduciary duty to the beneficiaries of the Trust (1/2) and a duty to balance the interests of both the life tenant and the remainderman (1/2).

The Trustees must get permission from the life tenant to sell the shares at undervalue (1/2) as it may reduce his potential for income from the Trust in the future (1/2).

Subtotal (2)

Total (4)

5.

Gain

	£
Painting (W1)	(1,000)
Necklace (W2)	1,666
Antique Car – note 1	<u>0</u>
Total Gain for 2022/23	<u>666</u> (1/2)

W1 The painting is a chattel, as it is a tangible movable asset that will last more than 50 years (1/2). As the proceeds are less than £6,000 and are less than cost the calculation of the loss is as follows:

	£
Proceeds (deemed to be £6,000)	6,000
Cost	<u>(7,000)</u>
Allowable Loss	<u>(1,000)</u> (1/2)

W2 The necklace is a chattel, as it is a tangible movable asset that will last more than 50 years (1/2). As the proceeds exceed £6,000 and exceed the cost the calculation of the gain is the lower of the gain using the normal capital gains rules:

	£	
Proceeds	7,000	
Cost	<u>(5,000)</u>	
Gain	<u>2,000</u>	(1/2)

Or the gain using the 5/3 rule: $5/3 \times (7,000 - 6,000) = £1,666$ (1/2)

The gain is therefore restricted to £1,666 (1/2)

Note 1 The antique car is a tangible asset with a useful life of less than 50 years. It is therefore a wasting chattel (1/2) and exempt from Capital Gains Tax.

Total (4)

6.

	£	
Proceeds	270,000	
Deduction under SP2/04 (0.8% x £240,000)	(1,920)	(1/2)
Cost (Probate Value)	<u>(240,000)</u>	(1/2)
Chargeable gain	<u>28,080</u>	
Tax @ 28%	<u>7,862</u>	(1/2)

No Annual exempt amount as fourth year of estate administration (1/2)

The loss on the share disposal cannot be considered within the Capital Gains Tax return as the shares were sold after the completion date for the residential property (1/2).

The Return and related payment is due 60 days after the completion of the sale ie by 29 January 2023. (1/2).

Interest is payable on any late payment from the due date 29 January 2023 to the date of payment at the HMRC agreed rate (currently 3.5%) (1/2). A penalty of the greater of £300 and 5% of the tax due will be payable as the return is more than 6 months but less than 12 months late (1/2). $£8,400 \times 5\% = £420$. (1/2)

Total Max (4)

7.

The transfer of shares into a charitable trust is exempt from tax (1) and is calculated on a “no gain, no loss” basis (1).

The base costs for the Trustees of the Bear Trust will be the base cost for the donor i.e., £285,000 (1).

Total Max (2)

8.

1)

No election

If no election is made, then Valerie will be treated as non-UK domiciled for IHT purposes. The spouse exemption available on Reggie's death will be restricted to £325,000. Her Spanish property will remain outside the UK IHT net. The Inheritance Tax will, therefore, be calculated as below:

On Reggie's death:

	£	
Gross Estate	2,400,000	
Less: Spouse Exemption (restricted)	<u>(325,000)</u>	(½)
Chargeable Estate	2,075,000	
Less: Nil Rate Band	<u>(325,000)</u>	
Taxable Estate	<u>1,750,000</u>	
IHT @ 40%	700,000	

On Valerie's death:

	£	
Gross Estate inherited (2,400,000 less 700,000 IHT)	1,700,000	(½) + (½)
Less: Nil Rate Band	<u>(325,000)</u>	
Taxable Estate	<u>1,375,000</u>	
IHT @ 40%	550,000	

Total IHT Paid (550,000 + 700,000) = £1,250,000 (½)

Election

If an election is made, Valerie will be treated as UK domiciled for IHT at the date of Reggie's death, giving her a full spouse exemption, but bringing her non-UK assets into charge to IHT on her death.

On Reggie's death, his estate will be covered in its entirety by spousal exemption (½).

On Valerie's death, IHT will be calculated as follows:

	£	
Gross Estate (2,400,000 + 1,200,000)	3,600,000	(½)
Less: Nil Rate Band	(325,000)	
Less: Transferable Nil Rate Band	<u>(325,000)</u>	(½)
Taxable Estate	<u>2,950,000</u>	
IHT @ 40%	1,180,000	

(for using own NRB of £325,000 in each comp (½))

(for using IHT rate of 40% in each comp (½))

Total

Max (4)

9.

Jessie has sold her main residence before she died but is still entitled to the residence nil rate band in relation to her former property. To calculate the downsizing addition:

Maximum RNRB available when the home was sold: £125,000 (1/2)

When sold the flat was worth £115,000 so 92% of the residence nil rate band available. (1/2)

There is no home in Jessie's estate when she dies, so she has lost 92% of her residence nil rate band .

The nil rate band in place at her time of death is £175,000 (1/2), so the downsizing addition available is (175,000 x 92%) £161,000 (1/2).

Total (2)

10.

For Capital Gains Tax purposes, we value shares in a quoted company by taking the average of the bid and offer prices. To value unit trusts, we simply take the lower of the bid prices.

For the Barley Trust, the valuation for Capital Gains Tax purposes is therefore as follows:

Shares in AZ Plc.	$(334 + 340)/2 \times 40,000 = £134,800$	(1)
Shares in BR Unit Trust	$222p \times 20,000 = £44,400$	(1)

Total (2)

11.

In considering whether there are any gifts with reservation of benefit (GWROB):

- 1) Jamie retains a limited benefit in the property, as she continues to stay in it for 3 weeks a year. However, this occupation falls below the "de-minimis" rules provided by HMRC as she is staying with her daughter for less than 1 month (1). There is therefore no Gift with Reservation of Benefit (1/2), and the house will not be included within her death estate.
- 2) As both Jamie and her son live in the property, s.102B(4) applies as Jamie pays a fair share of the bills (1), she is not receiving any benefit by reason of the gift to her son, and therefore there is no Gift with Reservation of Benefit (1/2), and the house will not be included within her death estate.
- 3) As a statement was made in the deed of variation under s.142 IHTA 1984, the variation is effective for Inheritance Tax purposes. As a result, the settlor of the Trust is Jamie's husband, and the Trust is not settlor-interested (1). There is therefore no Gift with Reservation of Benefit by Jamie (1/2), and the trust should not be included within her death estate.

Total Max (4)

12.

The Trust is resident in the UK (1/2) as:

- at least one Trustee (Dahlia) is resident in the UK (1/2); and,
- the settlor was domiciled or resident in the UK at the time they made the settlement (1/2)

As the trust is resident in the UK, it will be subject to UK Income Tax on its worldwide income (1/2).

If Sanjay was non-resident, but UK domiciled at the time he created the Trust then the Trust would still be resident in the UK and therefore there would be no change to the tax treatment (1/2).

If Sanjay was non-resident and non-UK domiciled (1/2) at the time he created the Trust, then the Trust would not be resident in the UK (1/2).

If the Trust is not resident in the UK, then the Trust is only chargeable to UK income tax on its UK source income (1/2).

Total (4)



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Part II Suggested Answers

Candidates will be given credit for relevant points not on the mark scheme.

13. 1)

		Interest	Dividends	
		£	£	
Gross income 2022/23				
Bank interest		4,000		½
ISA interest*		-		½
Dividends			18,000	½
Treasury stock interest		12,000		½
Total gross income		16,000	18,000	
Tax at 20%		3,200		½
Tax at 8.75%			1,575	½
Tax payable by Executors for 2022/23			<u>4,775</u>	
* ISA interest is exempt for 3 years after death/end of administration period if earlier				
Total marks for part 1				(3)

2)

		Interest	Dividends	
		£	£	
Gross income		16,000	18,000	
Tax at 20%		<u>(3,200)</u>	(1,575)	
Expenses			<u>(750)</u>	½
Net distributable income		12,800	15,675	½
R185:				
Net		12,800	15,675	
Tax		3,200	1,503	½
Gross		16,000	17,178	½
Total marks for part 2				(2)

3)

Luca will be subject to additional rate tax on the distributable income as calculated above, however adjustment is required for the pre-death income which has been charged to Inheritance Tax within Corina's estate.			1
Gross income accrued before death but received after death:			
Dividends	5,000		
Treasury stock interest	<u>2,000</u>		
Total	7,000		1
Tax at basic rate (20%)	1,400		1
Net pre-death income	<u>5,600</u>		

IHT attributable to net pre-death income:				
300,000 / 950,000 x £5,600	1,768			1
Gross up IHT at basic rate:				
1,768 x 100/80	2,210			1
Deduct from distributable income:				
		Interest	Dividends	
		£	£	
Gross distributable income per R185		16,000	17,178	
Less IHT adjustments:				
5,000 / 7,000 x 2,210			(1,579)	1
2,000 / 7,000 x 2,210		(631)		1
Income liable to tax on Luca at additional rates		15,369	15,599	
Additional tax payable at 45% - 20% = 25%		3,842		1
Additional tax payable at 39.35% - 8.75% = 30.6%			4,773	1
Total additional tax payable by Luca on estate income			8,615	
Claiming the adjustment:				
Relief for the IHT adjustment should be claimed in Luca's 2022/23 tax return.				
There is no box on the tax return in which to enter the adjustment for the IHT paid.				
The R185 figures should be entered on the trusts and estates pages as usual.				
The IHT adjustment should be shown within the "white space" box.				
				1
Total marks for part 3			max	(9)

- 4) Sharing the calculation with Luca is a disclosure to a third party, who is not party to the executors' contract with the firm. To avoid a breach of confidentiality, the firm should first check the terms of its engagement with the executors to see if such a disclosure has been agreed or whether consent should be sought before they release information to any third party including Luca (1).

To avoid a claim against the firm by Luca, they should be careful not to inadvertently assume a duty of care towards him, and so could caveat the calculation provided to him to include a statement that the advice has been prepared for the Executors based on information provided by them and that no liability is accepted to Luca or any third parties who choose to make use of that information (1).

Alternatively, it may be appropriate for the firm to accept that they owe a duty of care to Luca and enter a separate contract with him personally to enable them to tailor their advice to his specific circumstances (1).

If the firm does decide to engage Luca personally, they must be mindful of any potential conflict that may arise as a result of acting for both parties. In the event of such a conflict the firm should notify both parties, requesting permission to continue to act for both parties, or deciding to act for only one party (likely to be the executors as the first engaged and disengaging with the other (Luca) (1).

Other relevant implications gain credit.

Total marks for part 4

(4)

- 5) Luca does have legal rights under the General Data Protection Regulation (GDPR), and the Data Protection Act 2018 (1/2). He has a right to be informed about what data is being processed about him (1/2), and to access and rectify this data if it is wrong (1/2).

If he does not want his details to be used for the marketing project, he is also able to object to the purposes for which his personal data is being processed (1/2), and in certain circumstances be forgotten and have his data erased (1/2).

Total marks for part 5

MAX (2)

Total marks for question 13

(20)

14. 1)

	£	£	
IHT on lifetime transfers			
10 June 2017 – Barn to Simon			
Gift	60,000		
APR @ 100% *	<u>(60,000)</u>		½
PET		_____ nil	
11 July 2018 – Farmland to Mud Trust			
Gift	500,000		
APR @ 100% of agricultural value *	<u>(400,000)</u>		1
Chargeable	100,000		
Annual exemption 2018/19	(3,000)		½
Annual exemption 2017/18 (brought forward)	<u>(3,000)</u>		
CLT		94,000	
Nil rate band	325,000		½
Less chargeable transfers in previous 7 years	_____ Nil		½
Restricted		<u>(94,000)</u>	
Taxable		_____ nil	
15 October 2018 – Cash to Simon			
PET – no lifetime tax		<u>174,000</u>	½
30 December 2018 – Cash to Mud Trust			
Gift	425,000		
Annual exemptions already used	_____ nil		½
CLT		425,000	
Nil rate band	325,000		
Less chargeable transfers in previous 7 years	<u>(94,000)</u>		½
		<u>(231,000)</u>	
		<u>194,000</u>	
IHT at 20/80 (donor pays)		<u>48,500</u>	1
* APR available at 100% as farm building and farmland used in farm business			½
No BPR available as it is not the transfer of an asset used in Paddy's farming business			½
Total marks for part 1		MAX	(6)

2)

IHT on lifetime transfers as a result of death	£	£	
10 June 2017 – Barn to Simon			
Original gift	60,000		
APR @ 100% - not available due to sale of building	(nil)		½
PET	60,000		
Annual exemption 2017/18 – already used on CLT	Nil		½
Annual exemption 2016/17 – brought forward	(3,000)		½
Chargeable		57,000	
Nil rate band	325,000		½
Less chargeable transfers in previous 7 years	Nil		
		(57,000)	
Taxable		Nil	
11 July 2018 – Farmland to Mud Trust			
Original CLT	94,000		
APR withdrawn *	200,000		½
Chargeable		294,000	
Nil rate band	325,000		
Less chargeable transfers in previous 7 years	(57,000)		½
		(268,000)	
Taxable		26,000	
IHT at 40%		10,400	½
Taper relief (4-5 years = 40%)		(4,160)	½
Tax payable		6,240	
* APR is fully withdrawn on the half of the farmland that was sold even though proceeds were partially reinvested into APR assets			½
15 October 2018 – Cash to Simon			
Gift		174,000	½
Nil rate band	325,000		
Less chargeable transfers in previous 7 years (57,000 + 94,000*)	(151,000)		½
		(174,000)	
Taxable		nil	
* The cumulative total remains the original amount on the clock before the APR withdrawal			½
30 December 2018 – Cash to Mud Trust			
CLT (425,000 + 48,500)		473,500	½
Nil rate band fully utilised		nil	½
Taxable		473,500	
IHT at 40%		189,400	½
Taper relief (3-4 years) at 20%		(37,880)	½
Less lifetime tax paid		(48,500)	½
		103,020	
Total marks for part 2		MAX	(8)

3) The farmhouse will not qualify for APR within Paddy's death estate (1/2) because it is not occupied for the purposes of agriculture at the time of his death (1/2).

Total marks for part 3

(1)

Total marks for question 14

(15)

15. 1) Specific legacies of non-UK situs assets are tax-bearing; therefore, Henry will be liable to pay the IHT on the foreign share portfolio he receives (1/2).

Specific legacies of UK situs assets are tax-free; therefore, Phil will not be liable for the IHT on the painting he receives (1/2). Instead, this will be paid from the residue of the estate (1/2).

Bella will receive the residue of the estate net of any IHT payable both on the residue and on the painting (1/2).

Total marks for part 1

(2)

- 2)

	£	£	
IHT on Craig's death			
Death estate		850,000	
Nil rate band	325,000		1/2
Less chargeable transfers in previous 7 years	(nil)		
		(325,000)	
		<u>525,000</u>	
IHT @ 40%		210,000	1/2
Quick succession relief (QSR) available on foreign shares from Mary:			
Mary's gift to Craig (failed PET)	200,000		
AEs and nil rate band fully utilised on gift to trust	(nil)		1/2
Chargeable to IHT	<u>200,000</u>		
IHT @ 40%	80,000		1/2
QSR:			
The gift took place in August 2017 and Craig died in May 2019, therefore a percentage of 80% applies as it is between 1 and 2 years			1/2
As the gift was a failed PET, Craig is liable to pay the IHT on the gift			1/2
$\text{£}80,000 \times 80\% \times [(200,000 - 80,000) / 200,000]$		(38,400)	1
		<u>171,600</u>	
IHT on Phil's death			
Death estate		670,000	
Nil rate band	325,000		
Less chargeable transfers in previous 7 years	(280,000)		1/2
		(45,000)	
		<u>625,000</u>	
IHT @ 40%		250,000	1/2
Quick succession relief (QSR) available on painting from Craig, even though he no longer owns the painting at death:			
			1/2

As previously stated, the gift was of a UK asset, it was tax-free, meaning the IHT was paid from the residue of the estate.			
Estate rate on Craig's death estate:			
171,600 / 850,000 x 100%	20.2%		1
IHT paid on value of painting at estate rate:			
150,000 x 20.2%	30,300		1/2
QSR:			
The original transfer took place in May 2019 and Phil died in January 2023, therefore a percentage of 40% applies as it is between 3 and 4 years			1/2
£30,300 x 40%		(12,120)	1/2
		237,880	
Total marks for part 2			(8)

3)

On Craig's death, absolute legal and equitable ownership of the death estate assets passes to the executors of his estate (1).

During the estate administration, Henry, Phil and Bella do not have any legal or equitable ownership of any assets within the estate, they only have the right to require the estate assets to be properly administered (1).

The legal and equitable ownership of the foreign share portfolio, painting and residue of the estate passes to Henry, Phil and Bella respectively on completion of the administration of the estate (1).

If the executors' appropriate assets to Henry, Phil and Bella during the estate administration their legal ownership remains with the executors until the administration is complete (1/2), while the legatees receive equitable ownership under a bare trust arrangement immediately on appropriation (1/2).

Total marks for part 3

MAX (3)

Total marks for question 15

(13)

16. Email

To: Tax Partner
From: Tax Assistant
Date: October 2023
Subject: The Honey Trust

Hi Tax Partner,

Thank you for the details provided in your Memo, I will cover your queries in order.

1) Advancing trust capital to Elsa – tax implications

The distribution of the property would be chargeable to Capital Gains Tax (CGT), a capital gain will arise based on the market value of the property at the time of distribution, less the trustees' base cost (1/2). Any gain arising could be held over under s260 TCGA 1992 (1/2) because the transfer would give rise to an exit charge as it is a non-qualifying interest in possession trust (1/2), however the trustees should consider Elsa's future entitlement to principal private residence relief on the property as this would not be available if holdover relief were claimed (1/2).

Total marks for part 1 (2)

2) Advancing the rental property to Elsa – legal implications

Under s.32 TA 1925, the purpose of any advancement must be a recognised one, such as setting up house, rather than for day-to-day needs (1/2); this advancement is therefore likely to fall within this remit (1/2). The total amount advanced must be limited to Elsa's presumptive share of capital and must be set off against the total amount to which she is entitled (1/2).

The trustees would require the consent of Henrich should they decide to advance the property to Elsa (1/2) as it would affect his entitlement to the rental income which he currently receives (1/2).

Total marks for part 2 MAX (2)

[Scots Law alternative:

Under Scots law, the trustees may only advance capital to Elsa if they have the express power to do so under the trust instrument (1/2). The total amount advanced must be limited to Elsa's presumptive share of capital and must be set off against the total amount to which she is entitled (1/2).

The trustees would require the consent of Henrich should they decide to advance the property to Elsa (1/2) as it would affect his entitlement to the rental income which he currently receives (1/2).

Total marks for part 2 (2)]

3) a) Inheritance, Capital Gains Tax and legal consequences of Elsa dying before Henrich marries.

Elsa is the remainderman, and she has an absolute reversionary interest in the trust (1/2). This means that she has only a future entitlement to trust property, not a current entitlement

(1/2). There would therefore be no IHT or CGT consequences in relation to the trust property on her death as no assets would leave the trust (1).

As Elsa's reversionary interest is absolute, it means that her interest is vested (1/2). Should she die with Heinrich unmarried, her interest will pass into her estate and be inherited by the person identified in her Will (1/2), or under the intestacy laws if she has not made a Will (1/2). Her legatees would then acquire the trust property at the end of Heinrich's interest in possession (1/2).

b) Inheritance, Capital Gains Tax and legal consequences of Heinrich dying before he marries.

Should Heinrich die before he marries, the trust would be wound up and all assets distributed to Elsa as she would become absolutely entitled as against the trustees (1/2), this would give rise to an exit charge for IHT purposes (1/2).

There would also be a CGT charge on the distribution of the chargeable assets, based on their market value at Heinrich's death (1/2). Any capital gains could potentially be held over under s.260 TCGA 1992 (1/2).

Total marks for part 3 (6)

Total marks for question 16 (10)

Presentation skills – awarded for quality of written answers (2 marks)