

# May 2025 Examination

## PAPER 5

### Inheritance Tax, Trusts & Estates

Suggested Answers

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

1. There are two reliefs available on the trustees’ disposal of their Magpie Ltd shares as follows:

Business Asset Disposal Relief (BADR)

BADR is available (1/2) for the following reasons:

* Magpie Ltd is an unlisted trading company (1/2)
* Florence has a permanent life interest in the Wilder Trust (1/2); and

For a period of two years (1/2) ending within three years of the trustees’ disposal:

* Florence has personally held 7% of the shares in Magpie Ltd, which exceeds the 5% minimum (1/2)
* Florence has been an employee of Magpie Ltd (1/2)

Investors’ Relief (IR)

IR is available (1/2) for the following reasons:

* Magpie Ltd is an unlisted trading company (1/2)
* The trustees subscribed for the shares (1/2); and

For a period of three years (1/2) prior to the trustees’ disposal:

* The trustees have owned the shares (1/2)
* Nate has held a permanent life interest in the Wilder Trust (1/2)
* Nate has not been an employee of Magpie Ltd (1/2)

Amount of the respective claims – lifetime limits:

50% of the capital gain will qualify for BADR and 50% of the capital gain will qualify for IR due to there being two IIP beneficiaries who meet different qualifying conditions (1/2).

Any relief claimed will utilise Florence and Nate’s respective lifetime limits (1/2).

Florence has a BADR lifetime limit of £1 million (1/2) and has already utilised £730,000 on her previous disposal, therefore she has £270,000 remaining (1/2).

Nate has an IR lifetime limit of £10 million (1/2) and has already utilised £2 million on his previous disposal, therefore he has £8 million of his limit remaining (1/2).

Making the claim

Florence and Nate would need to make the claims jointly together with the trustees (1/2).

Total marks for part 1 Max (9)

1. Capital Gains Tax payable by the trustees for 2024/25

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
|  | BADR gains | IR gains | Other gains |  |
|  | £ | £ | £ |  |
| Invest plc shares: |  |  |  |  |
| £40,000 – £22,000 = £18,000 |  |  | 18,000 | ½ |
|  |  |  |  |  |
| Growth plc shares: |  |  |  |  |
| £30,000 – £45,000 = (£15,000) |  |  |  | ½ |
| Set loss against other gains for highest rate of relief |  |  | (15,000) | ½ |
|  |  |  |  |  |
| Magpie Ltd shares: |  |  |  |  |
| £812,500 – (2,500/10,000 x £250,000) = £750,000 |  |  |  | 1 |
| BADR applies to £750,000 x 50% = £375,000, restricted to a maximum of Florence’s remaining BADR lifetime limit:  Balance taxable at normal rates: | 270,000 |  | 105,000 | ½  ½ |
| IR applies to £750,000 x 50% (no restriction as Nate has £8million of lifetime limit remaining) |  | 375,000 |  | ½ |
|  |  |  |  |  |
| Annual exemption for trusts = £1,500 (no other trusts) |  |  |  | ½ |
| Set against gains taxed at highest rate |  |  | (1,500) | ½ |
|  |  |  |  |  |
| Totals | 270,000 | 375,000 | 106,500 |  |
|  |  |  |  |  |
| Tax at 10%/10%/20% | 27,000 | 37,500 | 21,300 | 1 |
|  |  |  |  |  |
| Total CGT payable by trustees for 2024/25 |  |  | 85,800 |  |
|  |  |  |  |  |
|  |  |  |  |  |
| Total marks for part 2 |  |  |  | (6) |

**Total marks for question 1 (15)**

2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Share Portfolio** | **Residential Apartment** | **Hamilton Foods Ltd** |  |
|  | **£** | **£** | **£** |  |
| Value of assets on 8 October 2024 | 292,000 | 450,000 | 50,000 | ½ |
| Value of assets on 20 May 2009 | (150,000) | (320,000) | (65,000) | ½ |
| Additional investment | (60,000) |  |  | ½ |
| IHT arising 150/670 x £111,000 | (24,851) |  |  | 1 |
| IHT arising 320/670 x £111,000 |  | (53,015) |  | 1 |
| IHT arising (100% Business Relief) |  |  | (0) | ½ |
| Less: Capital Improvements |  | (45,000) |  | ½ |
| Gain / Loss | 57,149 | 31,985 | (15,000) |  |
| Less: Annual exempt amount |  | (750) |  | 1\* |
| Pre-entitlement loss on Hamilton Foods Ltd |  | (15,000) |  | ½ |
| Taxable Gain | 57,149 | 16,235 |  |  |
|  |  |  |  |  |
| Capital Gains Tax @ 20% | 11,430 |  |  | ½ |
| Capital Gains Tax @ 24% |  | 3,896 |  | ½ |
| Total tax due |  | 15,326 |  |  |

*\*½ for allocation against residential property, ½ for halving as two settlements.*

There are no capital gains tax implications for the transfer of cash from the trust (1/2).

Under s. 260 holdover relief is available where the transfer is subject to an immediate Inheritance Tax Charge (1/2), so the trustees and the beneficiaries can make a joint claim for holdover relief within 4 years of the end of the tax year of disposal (i.e., by 5 April 2029) (1/2). The deferred gain will reduce the base cost of the assets in the hands of the beneficiaries to the value on 20 May 2009 plus the Inheritance Tax payable by on the exit from the trust on those assets (1/2).

Where a claim for holdover relief has been made and a beneficiary lives in the property as their principal private residence (PPR), no PPR relief will be available on the future disposal of the property by the beneficiary (1/2). Therefore, if the trustees and Ethan jointly make a claim for holdover relief to apply to the gain on the residential apartment, Ethan will lose the ability to claim PPR on any future sale of the apartment (1/2).

**Total (10)**

The trustees should report the Capital Gains on the sale of the property within 60 days of transfer using the online CGT reporting portal (1/2). The payment of tax on this transfer is also payable on this date (7 December 2024) (1/2). The gain on the transfer of the shares should be reported on the annual Trust Self-Assessment Tax Return by 31 January following the end of the tax year of disposal (31 January 2026) (1/2). The payment for the tax due on this gain is also due 31 January 2026 (1/2).

The trustees have a duty to update the HMRC Trust Register within 90 days of the cessation of the Trust (1/2) informing HMRC that the Trust has ceased.

**Max (2)**

As the transfer out of the trust happened more than 10 years after the commencement of the trust, the exit charge is calculated using the effective rate of the principal charge at the most recent 10-year anniversary (1/2)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **£** | **£** |  | |
| Value of Trust Fund on 20 May 2019  Less: Business Property Relief (10% Holding in Hamilton Foods Ltd) |  | 734,000  (70,000) | ½  ½ |
|  |  | 664,000 |  |
| Nil rate band | 325,000 |  | ½ |
| Less: Settlors cumulative transfers in 7 years before trust commencement | (210,000) |  | 1 |
| Less: Capital distributions in first 10 years | (45,000) |  | ½ |
|  |  | (70,000) |  |
|  |  | 594,000 |  |
|  |  |  |  |
| Notional Tax (594,000 x 20%) |  | 118,800 | ½ |
| Effective Tax Rate (118,800 / 664,000) |  | 17.891% | ½ |
|  |  |  |  |
| Actual rate on original trust assets 17.891% x 30% |  | 5.367% | ½ |
| Actual rate on additional investment (17,891% x 30% x ((40-36\*)/40) |  | 0.537% | 1 |
| \*quarters between creation and addition |  |  | ½ |
| IHT on original trust assets £600,000 x 5.367% |  | 32,202 | ½ |
| IHT on additional investment £64,000 x 0.537% |  | 344 | ½ |
| Total IHT payable |  | £32,546 | ½ |

Therefore, the exit charge on appointment of the assets out of the Trust:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **£** | **£** |  | |
| Value of the trust assets on 8 October 2024 (BPR qualifying assets excluded) | 768,000 |  | 1 |
| Less: Capital Gains Tax Due | (15,326) |  | 1 |
| Value of assets for distribution | 752,674 |  |  |
| Actual rate of exit charge (5.367% \* 21/40) | 2.818% |  | 1 |
| Exit charge (grossed up 752,674 x 2.818% x 100/(100-2.818) |  | 21,825 | 1 |

The IHT100 form declaring the exit charge was due 6 months following the end of month of transfer i.e., 30 April 2025 (1/2). Payment of tax was also due on this date (1/2).

**Total (13)**

**Total marks for question 2 (25)**

3.

1)

The gift is a potential exempt transfer (PET) for Inheritance Tax purposes and falls out of charge on Mr Lee’s death as it was made more than seven years prior (1/2).

Cash is not a chargeable transfer for Capital Gains Tax (CGT) purposes (1/2).

A pre-owned asset tax charge (1/2) arises for Income Tax purposes on the cash gift as Jake uses this cash to buy the static caravan and Mr Lee, as donor of the cash gift can benefit from this property (1/2). As the value of the caravan is greater than the cash gift, the POAT is apportioned (1/2). The charge is based on the market value rental (1/2).

|  |  |  |
| --- | --- | --- |
|  |  |  |
| Months between 6 April 2024 and Mr Lee’s death | 9 | ½ |
|  |  |  |
|  | **£** |  |
| Monthly rental value of caravan | 1,000 | ½ |
| POAT charge (1,000 x 9) | 9,000 | ½ |
|  |  |  |
| Apportionment (9,000 \* 150,000/200,000) | 6,750 | ½ |
| Tax @ 20%\* | 1,350 | 1 |

\*pro-rated pension of £18,000 x 9/12 = £13,500 fully utilises Mr Lee’s personal allowance

Mr Lee could have elected out of the POAT regime (1/2) and instead would have been treated as having made a gift with reservation of benefit which would be included within his death estate (1/2).

The deadline for making the election was 31 January following the end of the tax year in which Mr Lee first became liable for the POAT charge (i.e., 31 January 2021) (1/2).

Alternatively, Mr Lee could have paid an annual market rental to Jake of £12,000 for the duration of the time that he used the caravan (1/2).

**Max (7)**

2)

|  |  |  |  |
| --- | --- | --- | --- |
|  | **£** | **£** |  |
| Cash |  | 14,000 | 1 ½ \* |
| Quoted Share Portfolio |  | 260,000 |
| Personal Chattels |  | 17,500 |
| Main Residence (880,000/2 x 0.85)^ |  | 374,000 |
| Car |  | 8,000 |
|  |  |  |  |
| Less: Liabilities |  |  |  |
| Unsecured Personal Loan |  | (4,500) | ½ |
| Income tax liability to d.o.d. |  | (1,350) | ½ |
| Funeral Expenses |  | (3,000) | ½ |
| Total Estate |  | 664,650 |  |
|  |  |  |  |
| Less Charitable Donation |  | (14,000) | ½ |
| Less: Nil Rate Band | 325,000 |  | ½ |
| Gifts in 7 years pre-death | (460,000) |  | ½ |
|  |  | NIL |  |
|  |  | 650,650 |  |
| Tax payable at 40% |  | 260,260 | ½ |

\*1/2 mark for calculation of main residence, 1 mark for other assets

As Mr Lee retained an interest in his main residence the gift of the property was a Gift with Reservation of benefit (1/2). When Mabel returned to live in the property the gift with reservation of benefit was released (1/2).

To prevent a double charge, we must calculate the value of the PET on both the initial gift, and the release of reservation to determine which results in the higher tax liability (1/2).

|  |  |  |
| --- | --- | --- |
|  | £ |  |
| Value of deemed PET in August 2021 £800,000 – ((£800,000/2) x 0.85)^ | 460,000 | ½ |
| No Annual exemptions available on deemed PET | - | ½ |
| Less: NRB | (325,000) | ½ |
|  | 135,000 |  |
| Tax @ 40% | 54,000 | ½ |
| Less: Taper Relief (20% x 54,000) | (10,800) | ½ |
| Tax due on gift | 43,200 |  |

|  |  |  |
| --- | --- | --- |
|  | £ |  |
| Value of gift in November 2019  (£840,000 – ((£840,000/2 x 85%)^ | 483,000 | ½ |
| Less: AE (2019/20) | (3,000) | ½ |
| AE (2018/19) | (3,000) | ½ |
| Less: NRB | (325,000) | ½ |
|  | 152,000 |  |
| Tax @ 40% | 60,800 | ½ |
| Less: Taper Relief (60% x 60,800) | (36,480) | ½ |
| Tax due on gift | 24,320 |  |

^marks will be awarded whether or not discount applied

A higher tax charge is incurred from the release of the benefit and therefore this is included within the calculation of IHT on death (1/2).

The tax due on the deemed PET is to be paid by Mabel (1/2). The tax due on the death estate is to be paid by the executors (1/2).

The IHT is due 6 months following the end of the month of death, i.e., 30 June 2025. (1/2)

Max (12)

3)

On the identification of the error, the executors are required to submit amended Inheritance Tax calculations to HMRC using form C4 (1/2).

The executors of an estate are responsible for dealing with HMRC and reporting and paying the correct tax liabilities on behalf of the Estate (1/2). Where this isn’t done, the executors are not performing their duties, and may be personally liable for any losses to the Estate (1/2), i.e., penalties and interest from HMRC, and any resultant overdistributions to the beneficiaries.

As the Inheritance Tax due on the Estate has increased since the original submission, the executors are liable to interest on the underpayment from the deadline date (30 June 2025) to the date of payment at HMRC’s current rate of late payment interest (1/2).

If the executors fail to correct the IHT forms, and HMRC discover the error, they may be liable to a penalty on the underpaid tax (1/2). The rates of this penalty will depend on the perceived behaviour (1/2) as follows:

|  |  |  |
| --- | --- | --- |
| Careless Behaviour | 0-30% | (1) |
| Deliberate but not concealed | 20-70% |
| Deliberate and concealed | 30-100% |

Max (3)

4)

Under our professional obligations, we should advise the executors to correct the Inheritance Tax forms (1/2) and explain the implications of not completing the forms (1/2). If the executors still refuse to amend the forms, we should consider filing a report under the Proceeds of Crime Act to the NCA(1/2). It is important not to inform the executors that we are doing this, to avoid falling foul of the “tipping off” legislation (1/2).

Once a report has been filed, we should consider disengaging from the client (1/2) and not completing any further work on their behalf. We should issue a disengagement letter, withdrawing our responsibilities to act on behalf of the Estate (1/2).

Total (3)

**Total marks for question 3 (25)**

4.

Email

From: Tax Adviser

To: Richard Smythe (Executor of Adnan Firman’s estate)

Date: 6 May 2025

Subject: The Estate of Adnan Firman

Dear Richard,

Thank you for your email. Please find the answers to your queries below.

1. i) Redirection of assets

*Painting*

Nancy is under no obligation to accept the painting (1/2). She could make a formal disclaimer (1/2) which would automatically redirect the painting to Polly who is receiving the residue of Adnan’s estate (1/2). However, as she does not want the painting to pass to Polly, it would be better for her to use a Deed of Variation (1/2) which would allow her to redirect the painting to a beneficiary of her choice, in this case Simon (1/2).

In order for the Deed of Variation to be valid, it must be in writing (1/2) and signed by Nancy (1/2) before 2 November 2026 (1/2). Also, Nancy should receive no consideration from Simon for making the variation (1/2).

When Nancy makes the variation of the painting it will be treated as a potentially exempt transfer (PET) by her (1/2) as it is a transfer to another individual (1/2).

If Nancy were to die withing 7 years the failed PET would become chargeable as part of her estate (1/2), to avoid this she could include a statement under s.142 IHTA 1984 within the Deed of Variation (1/2) to treat the gift of the painting as though Adnan had made it via his will (1/2).

If the variation meant that more IHT would be payable by Adnan’s estate, then you, as Executor of the estate, would need to consent (1/2), but as the original gift to Nancy does not benefit from any IHT exemptions and the painting would instead pass to another chargeable beneficiary no such consent would be required (1/2).

*Shares in ARC Ltd*

A Deed of Variation can be signed by Polly to redirect the shares in ARC Ltd to Mo. Again, the variation must be in writing and made by 2 November 2026 and a s.142 IHTA 1984 election is recommended (as above) (1/2).

The spousal exemption would have been available originally on the asset passing to Polly (1/2), whereas a transfer to Mo would be chargeable to IHT on Adnan’s estate (1/2). However, business property relief (BPR) would be available on the shares instead (1/2), meaning that no additional IHT would arise as a result of the variation, and no Executor consent is therefore required (1/2).

*Investment portfolio – gifts to Mo’s adult children*

Again, these redirections could be made by a Deed of Variation by Polly (as above) (1/2). This time, however, it would result in an increase to the IHT payable (1/2), so your consent, as Executor, would be required (1/2). HMRC would also need to be notified within six months of the variation being made using form C4 (1/2).

*Charity donation*

If Polly makes the charity donation before 2 November 2026 (1/2), it will be treated as though Adnan had made the donation via his will (1/2) under s.143 IHTA 1984. No formal Deed of Variation will be needed (1/2), and the donation will be effective for IHT purposes in reducing the chargeable value of Adnan’s estate (1/2).

Total marks for part 1 Max (14)

1. Calculate the charity donation required to obtain the 36% rate on Adnan’s estate:

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | £ | £ |  |
| Adnan’s estate: |  |  |  |
| Painting |  | 150,000 |  |
| Main home |  | 850,000 |  |
| Investment portfolio |  | 1,200,000 |  |
| Shares in ARC Ltd, unquoted trading company | 330,000 |  |  |
| BPR at 100% | (330,000) |  | ½ |
|  |  | - |  |
|  |  | 2,200,000 |  |
| Spouse exemption for assets left to Polly:  Main home  Investment portfolio of £1,200,000, less 4 x £250,000 left to children |  | (850,000)  (200,000) | ½  ½ |
| Chargeable estate |  | 1,150,000 |  |
|  |  |  |  |
| Nil rate band (including transferable nil rate, which is available in full): £325,000 x 200% |  | (650,000) | 1 |
|  |  |  |  |
| Baseline amount |  | 500,000 |  |
|  |  |  |  |
| Gross up baseline amount due to exempt residue: 500,000 x 100/64 |  | 781,250 | 1 |
|  |  |  |  |
| Baseline amount x 10% |  | 78,125 | ½ |
|  |  |  |  |
| Polly should therefore donate £78,125 to charity in order for the estate to be taxed at 36% | | |  |
|  |  |  |  |
| Total marks for part 2 |  |  | (4) |

I trust the above answers your queries.

Kind regards,

Tax Advisor

**Total marks for question 4 (18)**

5. 1) Income Tax payable by the Corn Discretionary Trust for 2024/25:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Non-savings | Interest | Dividend |  |
|  | £ | £ | £ |  |
| Dividend income |  |  | 26,000 | ½ |
| Bank interest |  | 3,000 |  |
| Rental profits from residential investment property:  £12,000 - £1,650  \*No deduction for new porch as it is a capital expense | 10,350 |  |  | ½  ½ |
| UK chargeable event gain | 14,400 |  |  | ½ |
| Rental profits from commercial investment property:  £13,800 x 8/12  \*No deduction for legal fees as these are a capital expense | 9,200 |  |  | ½  ½ |
|  |  |  |  |  |
| Total income | 33,950 | 3,000 | 26,000 |  |
|  |  |  |  |  |
| Expenses:  £1,825 x 100/91.25  \*Deemed to have been paid from dividend income in priority to savings and non-savings income |  |  | (2,000) | 1  ½ |
|  |  |  |  |  |
| Income after expenses | 33,950 | 3,000 | 24,000 |  |
|  |  |  |  |  |
| Tax payable: |  |  |  |  |
| Rates applicable to trusts: |  |  |  |  |
| £33,950 x 45% | 15,278 |  |  | ½ |
| £3,000 x 45% | 1,350 |  |  | ½ |
| £24,000 x 39.35% | 9,444 |  |  | ½ |
| £2,000 x 8.75% | 175 |  |  | ½ |
|  |  |  |  |  |
| Tax liability | 26,247 |  |  |  |
|  |  |  |  |  |
| Add liability from tax pool (see below) | 8,935 |  |  | ½ |
|  |  |  |  |  |
| Deduct notional tax on UK chargeable event gain | (2,880) |  |  | ½ |
|  |  |  |  |  |
| Total tax due | 32,302 |  |  |  |
|  |  |  |  |  |
| Tax Pool |  |  |  |  |
|  |  |  |  |  |
| Balance brought forward on 6 April 2024 | 600 |  |  | ½ |
| Add: |  |  |  |  |
| Tax paid at 45% (£15,278 + £1,350) | 16,628 |  |  | ½ |
| Tax paid at 39.35% | 9,444 |  |  | ½ |
|  | 26,672 |  |  |  |
| Less: |  |  |  |  |
| Notional tax on UK chargeable event gain :  £14,400 x 20% | (2,880) |  |  | 1 |
| Credits paid on distributions to beneficiaries:  £20,000 x 2 x 45/55 | (32,727) |  |  | 1 |
|  |  |  |  |  |
| Tax payable | (8,935) |  |  | ½ |
|  |  |  |  |  |
| Tax pool carried forward on 5 April 2025 | nil |  |  |  |
|  |  |  |  |  |
| Total marks for part 1 |  |  | MAX | (11) |

1. Payments on account due to be made by the trustees for 2025/26:

|  |  |  |
| --- | --- | --- |
|  |  |  |
|  | £ |  |
| Due 31 January 2026 (£32,302 / 2) | 16,151 | ½ |
| Due 31 July 2026 (£32,302 / 2) | 16,151 | ½ |
|  |  |  |
| Total marks for part 2 |  | (1) |

1. Gilda’s tax position for 2024/25:

|  |  |  |
| --- | --- | --- |
|  | £ |  |
| Employment income | 13,500 |  |
| Trust income:  £20,000 x 100/55 | 36,364 | 1 |
|  |  |  |
|  | 49,864 |  |
|  |  |  |
| Personal allowance 2024/25 | (12,570) | ½ |
|  |  |  |
| Taxable income | 37,294 |  |
|  |  |  |
| Tax payable  £37,294 x 20% | 7,459 | ½ |
| Less: |  |  |
| Tax credit on distribution:  £20,000 x 45/55 | (16,364) | 1 |
|  |  |  |
| Tax repayable to Gilda | (8,905) |  |
|  |  |  |
| Total marks for part 3 |  | (3) |

**Total marks for question 5 (15)**