

Institution **CIOT - ATT**  
Course **ATT Paper 5 IHT Trusts and Estates**

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Exam ID

Count (s)	Word (s)	Char (s)	Char (s) (WS)
Section 1	<b>708</b>	<b>3290</b>	<b>3951</b>
Section 2	<b>511</b>	<b>2479</b>	<b>2922</b>
Section 3	<b>653</b>	<b>2883</b>	<b>3490</b>
Section 4	<b>780</b>	<b>3627</b>	<b>4387</b>
Section 5	<b>242</b>	<b>1155</b>	<b>1336</b>
Section 6	<b>0</b>	<b>0</b>	<b>0</b>
Total	<b>2894</b>	<b>13434</b>	<b>16086</b>

Answer-to-Question- \_1\_

### 1 Capital gains tax reliefs

Business asset disposal relief (BADR) is likely available to the trustees in respect of Florence's share of the disposal in Magpie Ltd as the trustees will be disposing of trust business assets which are settled property.

Florence is a qualifying beneficiary with an interest in possession (IIP) - this is required for BADR and her IIP is not for a fixed term. Florence has had an IIP in the trust since its creation.

Further conditions for the disposal of Magpie Ltd shares to qualify for BADR include that the shares are in a trading company, which Magpie Ltd is as it manufactures and distributes bird products.

Magpie Ltd must also be the personal trading company of the qualifying beneficiary - Florence. This means that Florence owns at least 5% of the shares and is an employee of Magpie she qualifies for BADR.

There is no minimum holding requirement of the trustees.

Florence and the trustees should enter into a joint election for BADR to reduce the rate of capital gains tax (CGT) to a flat rate of 10% on a lifetime limit of £1,000,000 of gains. This is Florence's lifetime limit and her previous gain of £730,000 would have used some of that limit as she claimed reliefs at the time. Therefore, Florence can only claim it on a maximum of £270,000 worth of gains.

It must be a joint election by Florence and the trustees.

Nate doesn't meet the conditions for BADR however as he never worked for Magpie, despite owning more than 5%.

BADR is therefore available to reduce the rate of CGT charged on 50% of the trustees gain on the Magpie shares to 10%, up to Florence's remaining allowance of £270,000.

Investor's Relief (IR) will be available for Nate's portion of the gain.

IR is available where the trust subscribed for shares in an unlisted trading company and held the shares for 3 years prior to disposal. The trustees here subscribed for the Magpie shares in May 2018 and disposed of them in October 2024 so these conditions are met.

There must also be a qualifying beneficiary to the trust - this is someone with an IIP that is not for a fixed term and has had the IIP for 3 years prior to the sale. Nate has such an IIP and has had it for approx 9 years prior to the sale, starting in 2015.

Only Nate has not been an employee of Magpie for the 3 years prior to sale also. Florence would therefore not qualify for IR.

IR is therefore available to reduce the rate of CGT charged on Nate's 50% of the trustees' gain to 10% up to Nate's lifetime limit of £10,000,000 as reduced by his previous gain of £2,000,000 for a total remaining limit of £8,000,000. Again a joint election is needed as it will be using Nate's allowance.

Any proceeds in excess of Nate's and Florence's respective remaining BADR/IR limits will be subject to CGT at the standard rate of 20%.

## 2 Calculation of CGT

Invest plc

	£	£	
Proceeds		40,000	
Less cost		(30,000)	
Gain		10,000	

Growth

	£	£	
Proceeds		30,000	
Less cost		(45,000)	
Gain		(15,000)	

Florence BADR

Proceeds		406,250	
Less cost		(31,250)	
Gain		375,000	

Nate IR

Proceeds		406,250	
Less cost		(31,250)	
Gain		375,000	

	Standard	IR	BADR
Gains/Loss			
Invest	10,000		
Growth	(15,000)		
Magpie	103,000	375,000	270,000
total	98,000		
Less AEA for trustees	(1,500)		
Chargeable	96,500	375,000	270,000
CGT @ 20%	19,300		
CGT @ 10%		37,500	27,000

Trustees CGT AEA is 1/2 as for individuals = £1,500

Trust AEA split amongst all trusts by same settlor but Alice only set up 1 so fully amount available.

Allocate AEA against gains charged at highest rate.

Florence's share of Magpie gains only eligible for BADR up to her remaining lifetime allowance of £1,000,000 - £730,000 = £270,000 from previous disposals where BADR claimed.

Nate has £8,000,000 of IR gains remaining and sale of Magpie within that so entirety eligible for 10% CGT rate.

10,000 Magpie shares bought for £250,000 and 2,5000 (25% holding) sold so apportion base cost by 25% = £62,500

Florence and Nate entitled to 50% share of proceeds so 25% sale base cost divided by 2 for each's base cost = £31,250

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 -----ANSWER-1-ABOVE-----  
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 -----ANSWER-2-BELOW-----  
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Answer-to-Question- 2

1

When assets are distributed out of a trust to beneficiaries, this is a disposal at market value.

The trustees and beneficiaries can enter into holdover relief elections to defer the trustees' capital gain as the transfer out of trust is also subject to IHT charges so s 260 elections are available. This would roll over any of the trustees' gain against the base cost of the beneficiaries which likely means the beneficiaries will have larger chargeable gains when they dispose of the asset in the future.

Further, where PPR is available for Ethan, a holdover relief claim will prevent him claiming full PPR on the apartment which he is now living in when he sells it. It is therefore likely Ethan will not want to enter into a holdover relief election as he will have a significant chargeable gain when disposing of his home if he does. PPR will otherwise be available to reduce the chargeable gain, likely to close to Nil if he does not sign a s 260 election.

The elections must be joint and so the trustees must have the consent of the beneficiary to do so.

If no holdover relief elections are entered into the beneficiaries' base cost will be the market value of the assets received at the date of distribution.

Disposal of apartment to Ethan:

	£	£	
Proceeds		450,000	
Less cost	320,000		
Less enhancement	45,000		
		(365,000)	
Gain		85,000	
NB less IHT entry charge £111,000 x 320/670 =		Gain = 31,985	

53,015			

Quoted shares

	£	£	
Proceeds		220,000	
Less cost		(150,000)	
Gain		70,000	
NB Less IHT paid on entry £111,000 x 150/670		(24,851)	
	Gain	45,149	

Hamilton foods

	£	£	
Proceeds		50,000	
Less cost		(65,000)	
Gain		(15,000)	
Less £111,000 x 65/670		(10,769)	
		(25,769)	

No BADR available as no evidence that beneficiaries worked there.

Quoted shares (additional)

	£	£	
Proceeds		72,000	
Less cost		(60,000)	
Gain		12,000	

Cash is not chargeable to CGT.

	Standard gains	Residential gains	
Apartment		31,985	
Quoted shares	45,149		
Hamilton Foods	(25,769)		
Additional quoted shares	12,000		
Gains	31,380	31,985	
Trust AEA		(750)	trustee AEA of £1,500 split between two trusts of settlor
Chargeable	31,380	31,235	
CGT @ 20%	6,276		
CGT @ 24%		7,496	

2

3

	£	£	
Value of trust at principal date	734,000		
Less BPR	(70,000)		
		664,000	
Initial value of related trusts		Nil	none on same day
		664,000	
NRB at principal	325,000		
Less transfers <7 years before creation of trust	(210,000)		
Less capital distributions	(45,000)		
NRB remaining		(70,000)	
Taxable		594,000	
Notional IHT	594,000 x 20%	118,800	



Effective rate	$118,800/664,000 \times 100$	17.892%	
Actual	$17,892\% \times 30\% \times 40/40$	5.368%	
Principal charge on additional quoted shares	$17.892\% \times 30\% \times (40-36)/40 \times 64,000$	344	extra funds not in trust for first 36 quarters
Principal charge on remainder	$5.368\% \times 600,000$	32,208	

Total principal charge = £32,208 + £344 = £32,552

Due 6 months after end of month of transfer = 30 November 2019

Nothing happened after principal so same effective rate applies

Actual rate =  $17.892\% \times 30\% \times 21/40 = 2.818\%$

Value leaving trust = £818,000

Exit charge =  $£818,000 \times 2.818\% = £23,051$

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 -----ANSWER-2-ABOVE-----  
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-----ANSWER-3-BELOW-----  
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Answer-to-Question- \_3\_

1

The caravan is a pre-owned asset for inheritance tax purposes.

On the basis that the static caravan is land (as it is tangible, immovable property, being static) Mr Lee will have an income tax charge calculated on the annual rental value of the land. If it were moveable, and therefore a chattel, the income tax would be calculated as the value of the caravan x HMRC official rate of interest, which is currently 2.25%

The annual rental value of the caravan for 2024/25 would be £1,000 x 9 = £9,000 as Mr Lee died 9 months into the tax year. This would have been subject to income tax at 20% as Mr Lee is a basic rate taxpayer, so the tax due from the POAT gift would be £1,800 as Mr Lee's pension would utilise his personal allowance.

Mr Lee could have avoided the POAT charge by waiting 7 years after first gifting Jake the cash to start using the caravan.

Mr Lee could also make an election for the gift to have been treated as a reservation of benefit instead. The election should have been made by the 31 January after the tax year Mr Lee was first able to use the caravan.

2

Mr Lee gifted a share of his house to Mabel and continued to live there alone for a period. This is a gift with reservation and a PET.

	£	£	
Gift of 50% of house		420,000	
Less AE x 2 (2019/20 and 2018/19)		(6,000)	
PET		414,000	PET failed as died within 7 years
NRB at death	325,000		
Less transfers <7 years prior to gift	(150,000)		

NRB remaining		(175,000)	
Taxable		239,000	
IHT @ 40%		95,600	
Less taper relief	5-6 years = 60%	(57,360)	
IHT due		38,240	Not chargeable as below calculation is higher.

The release of the gift with reservation is itself a PET. As Mabel only had a share of the property and they occupied it together it is no longer a GWROB, providing bills are shared.

	£	£	
Gift of 50% of house		400,000	
Less AE x 2 (2021/22 and 2020/21)		(6,000)	
PET		394,000	Failed PET
NRB at death	325,000		
Less transfers <7 years prior to gift	(150,000)		
NRB remaining		(175,000)	
Taxable		219,000	
IHT @ 40%		87,600	
Taper relief	3-4 years = 20%	(17,520)	
IHT due		70,08	payable by Mabel 6 months after end of month of death - 30 June 2025

Latter PET has higher liability so take that value only

	£	£	
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Cash		14,000	
shares		260,000	
chattels		17,500	
Car		8,000	
50% share of hosue		440,000	
Assets		739,500	
Less liabilities			
income tax	$((9,000 + 18,000) - 12,570) \times 20\% = 2,886$		
funeral costs	3,000		
loan	4,500		
		(10,386)	
Death estate		729,114	
Less charity exemption		(14,000)	Not enough for 36% as <10% baseline
Chargeable		715,114	
IHT @ 40%		286,046	

IHT is due on the death estate on the later of:

- 6 months from the end of the month of death, in this case 30 June 2025 and
- when the IHT return is filed

IHT on the death estate is payable by the executors

3

If the forms are not corrected the executors may face penalties for incorrect returns. These will depend on whether the executors were careless, deliberate but not concealed, or deliberate and concealed.

The penalties will be reduced for unprompted disclosure and could therefore be as low as 0%. For prompted disclosure the lowest penalty would be 15%

If no disclosure is made penalties will range from 30% to 100% of the tax due.

Penalties are charged for each error on the return.

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If the executors took reasonable care when filing the return there will be no penalties. If they filed the return without inclusion of the lifetime gifts because Mabel failed to tell them about it, these failures will be considered deliberate and the minimum penalties will be 50% of the tax undeclared and will be payable by Mabel, not the executors.

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-----ANSWER-3-ABOVE-----  
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-----ANSWER-4-BELOW-----  
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Answer-to-Question- \_4\_

Firm address

Client address

Date

Dear Mr Smythe

Thank you for your correspondence. I set my answers to your queries out below.

#### Redirecting assets

If a beneficiary does not wish to receive the assets left to them in a Will, they can enter a deed of variation.

A deed of variation essentially has the effect of re-writing the will so the assets are treated as being transferred to the beneficiary's chosen other person in the Will, rather than them. Providing the deed is made under s 62 TCGA 1992 it also has the effect of ensuring there is no capital gains tax payable. Without s 62, a deed of variation would be a disposal at market value by the original beneficiary. A similar election should be made for inheritance tax purposes under s 142 IHTA to avoid the beneficiary making a PET - without this election, if Nancy or Polly were to die within 7 years of making a deed of variation, there would be an inheritance tax charge on the value of the assets they received and reallocated.

For a deed of variation to be valid it must meet the following conditions:

- be in writing
- be signed by the person giving up their inheritance to the other
- be signed within 2 years of the date of death, in this case by 2 November 2026.
- if the deed of variation results in more IHT becoming payable, the executors must consent to the variation, this is particularly pertinent to Polly.

Nancy signing a deed of variation to give her brother the painting will not have any inheritance tax effects as Nancy is not the subject of any relevant exemptions which would be disrupted by the deed of variation. As mentioned above, she should make the necessary elections to ensure she does not make a potentially exempt transfer or have

capital gains tax liabilities. The executors will not have to consent to this deed of variation as no additional IHT is due.

However, Polly's deeds of variation are likely to have inheritance tax consequences as assuming Polly is also UK domiciled, the remainder of Adnan's estate will have passed to Polly free of IHT under the spousal exemption.

The transfer of the shares in ARC Ltd may qualify for BPR if Adnan had held them for 2 years prior to his death. If this is the case then a deed of variation would not result in additional IHT being due from the deed of variation, as they would qualify for 100% BPR. This is also on the basis that there are no excepted assets (eg excess cash) in ARC Ltd. If BPR does not apply however, then it is likely that a deed of variation will result in IHT being due. If so, the executors will have to consent to the deed of variation.

The investment portfolio is unlikely to qualify for BPR and is therefore more likely to cause an inheritance tax charge if Polly enters a deed of variation to give them to her grandchildren. The executors will have to consent to this variation.

Entering a deed of variation to leave assets to charity would not generate any additional IHT as it would be covered by the charity exemption. The executors therefore do not need to consent to it.

Polly may want to consider entering a deed of variation to pass the Adnan's main home to one of his children or grandchildren to utilise Adnan's residential nil-rate band (RNRB). However, if she chooses not to then Adnan's unused RNRB can be transferred and utilised by her own estate if she leaves a property which has been her residence to her lineal descendants (children/grandchildren).

No consideration should be given to either Nancy or Polly for any deeds of variation entered into.

#### Donation to charity

Where the deceased leaves 10% or more of their net estate ("baseline amount") to charity then the taxable estate is charged at 36% rather than 40%.

The below calculations assume that the ARC shares qualify for 100% BPR (meaning that Adnan held them for 2 years prior to his death). If this is not the case the value of the shares will also be chargeable.

	£	£	
Painting		150,000	
Main home	850,000		

Less spousal exemption	(850,000)		
Investment portfolio		1,200,000	
Shares in ARC	330,000		
Less BPR	(330,000)		
Gross estate		1,350,000	
Less NRB at death		(325,000)	No lifetime transfers
Baseline amount		1,025,000	
10% baseline		102,500	

Polly should therefore enter a deed of variation which leaves £102,500 to charity to obtain the 36% charity rate.

I trust the above is satisfactory, but should you have any further questions, please let me know

Yours sincerely,  
 ATT adviser

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 -----ANSWER-4-ABOVE-----  
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 -----ANSWER-5-BELOW-----  
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Answer-to-Question- \_5\_

1

	NS	S	Div	Expenses
Dividend income			26,000	
Bank interest		3,000		
Rental income	12,000			
Less fence repair	(1,650)			
Expenses 1,825 x 100/91.25			(2,000)	2,000
Total	10,350	3,000	24,000	2,000
*add commercial rental property £13,800 x8/12 and chargeable event	+9,200 + 14,400 = £47,600			
RAT				
NS @ 45%	21,420			
S @ 45%	1,350			
Div @ 39.35%	9,444			
Expenses @ 8.75%	175			
Tax payable by trustees	33,960			

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Tax pool	£	£	
tax pool b/f		600	
tax paid by trustees		32,210	
tax credit for distributions	(20,000 x 2) x(44/55)	(32,727)	
tax pool c/f		83	

Rental expenses are deductible from rental income but only those that represent a revenue expenditure. Building a new porch is therefore not allowable. Neither are legal fees for the acquisition of a new property. Both are capital expenditure.

The beneficiaries receive their income distributions net of a 45% tax credit which can be claimed on their own self assessment returns.

2

Payments on account are 50% of the tax paid in the previous year. They are due on 31 January in the tax year and 31 July immediately after the end of the tax year.

Tax due for 2024/25 = 33,960

Payments on account = £16,980 each

£16,980 due on 31 January 2026 and 31 July 2026

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R185	Net	Tax	(Gross)
trust income	20,000	16,364	36,364

		NS	
employment income		13,500	
trust income		36,364	
total		49,863	
Less personal allowance		(12,570)	

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taxable		37,294	
20%		7,585	
trust tax credit		(16,364)	
tax repayable		(8,779)	

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-----ANSWER-6-BELOW-----  
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Answer-to-Question- \_6\_