May 2026 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Suggested Answers

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

1.

1) There are two reliefs available on the trustees' disposal of their Flair Ltd shares as follows:

Business Asset Disposal Relief (BADR)

Anya

If the shares were sold on the earlier option of 10 April 2025, BADR would not be available (1/2) as Anya would not have held her 5% shareholding for the required two years ahead of the disposal (1/2).

If the shares were sold on the latter option of 10 September 2025, BADR would be available (1/2) on 50% of the capital gain arising on the sale of the Flair Ltd shares (1/2) for the following reasons:

- Flair Ltd is a trading company (1/2)
- Anya has a permanent life interest in the Style Trust (1/2); and

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

- Anya has personally held 5% of the shares in Flair Ltd, which meets the 5% minimum (1/2)
- Anya has been an employee of Flair Ltd (1/2)

Hazel and Mateo

BADR relief would not be available on the other 50% of the capital gain arising on the sale of the Flair Ltd shares (1/2) as Hazel did not own any Flair Ltd shares (1/2) and Mateo was not employed by Flair Ltd (1/2).

Investors' Relief (IR)

Hazel and Mateo – 10 April 2025 disposal

If the shares were sold on the earlier option of 10 April 2025, IR would not be available in respect of 25% of the capital gain (1/2), as Hazel worked for Flair Ltd within 3 years prior to that date (1/2).

IR would be available on 25% of the capital gain attributable to Mateo's IIP share, as he met all the conditions as below (1/2).

Hazel and Mateo – 10 September 2025 disposal

If the shares were sold on the latter option of 10 September 2025, IR would be available (1/2) on 50% of the capital gain arising on the sale of the Flair Ltd shares (1/2) for the following reasons:

- Flair 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)
- Mateo and Hazel have held permanent life interests in the Style Trust (1/2)
- Mateo and Hazel have not been employees of Flair Ltd (1/2)

Anya

IR would not be available on 50% of the capital gain (1/2), as Anya worked for Flair Ltd throughout (1/2).

Amount of the respective claims – lifetime limits:

Any relief claimed will utilise the beneficiaries' respective lifetime limits (1/2).

Anya has a BADR lifetime limit of £1 million (1/2).

The IR limit reduced from £10 million to £1 million for disposals after 30 October 2024 (1/2) whilst considering any prior disposals made (1/2). Hazel has an IR lifetime limit of £1 million (1/2). Mateo had an IR lifetime limit of £550,000 (£1 million - £450,000) of his limit remaining (1/2).

Making the claim

Anya, Hazel, and Mateo would each need to make any claims for relief jointly with the trustees (1/2).

Total marks for part 1 Max (13)

2) CGT payable on sale of Flair Ltd shares by trustees:

Disposal on 10 April 2025:				
	IR gains	Other gains		
	£	£	£	
Gain on disposal of Flair Ltd shares:				
(400 x £2,000) – (400/600*£300,000) = £600,000				1
IR available on 25% of gain	150,000	450,000		½
Brought forward losses - £2,000				½
Set loss against other gains for highest rate of relief		(2,000)		½
Annual exempt amount for trusts = £1,500				½
No reduction in annual exempt amount for charitable settlement or overseas settlement				½
Set against gains taxed at highest rate		(1,500)		½
Totals	150,000	446,500		
Tax at 14%/24%	21,000	107,160		1
Total CGT payable by trustees for 2025/26			£128,160	
Disposal on 10 September 2025:				
	BADR gains	IR gains		
	£	£		
Gain on disposal of Flair Ltd shares:				
BADR available on 50% of gain/IR available on 50% of gain	300,000	300,000		1
Brought forward losses - £2,000	(2,000)			PAG
Annual exempt amount	(1,500)			PAG
Totals	296,500	300,000		
Tax at 14%	41,510	42,000		½
Total CGT payable by trustees for 2025/26			£83,510	
Disposal on 10 September 2025 would minimise the trustees' CGT liability				½
Total marks for part 2				(7)

Total marks for question 1 **(20)**

2.

1) The income tax is as follows:

2024/25

	£	£	
Interest		2,000	
Rental Income	28,000		
Rental Expenses	(5,000)		½
Taxable income	23,000	2,000	
Tax @ 20%	4,600	400	½
Gross Distributable Income	18,400	1,600	
Less TME's	(400)	(1,600)	1
Net distributable income	18,000	nil	

2025/26

	£	£	
Interest		2,000	
Rental Income	38,000		
Rental Expenses	(3,000)		½
Taxable Income	35,000	2,000	
Tax @ 20%	7,000	400	½
Gross distributable income	28,000	1,600	
Less: Management Expenses	(400)	(1,600)	1
Net distributable income	27,600	nil	

2024/25

Jessica, William, and Zack – R185

	Net £		Tax £	
Non-Savings Income at basic rate	6,000	½	1,500	1

2025/26

Jessica, William, and Zack – R185

	Net £		Tax £	
Non-Savings Income at basic rate	9,200	½	2,300	1

(7)

2)

Inheritance Tax will become due when Jessica and William become entitled to their share of the capital at the age of 25 (1/2).

The IHT exit charge is calculated based on the initial value of the trust (1/2) as follows:

		£	
Initial value of Trust Property		350,000	½
Value of related settlements		0	½
Less: Nil rate band	325,000		½
Settlors' chargeable transfers in previous 7 years	(50,000)		1
		(275,000)	
		75,000	
Notional tax @ 20%		15,000	½
Effective rate (15,000 / 350,000)		4.286%	1
Actual Rate (4.286 x 30%)		1.286%	1
Loss to Trust ((450,000+45,000)/3) = 165,000 x 2		330,000	1
Exit charge rate (1.286% x 28/40)		0.900%	1
Exit Charge (330,000/(100-0.900) x 0.900%)		2,997	1

Following Crowe v Appleby (1/2), where a beneficiary becomes entitled to an 'undivided share' in land – i.e. a right to part of the sales proceeds once the land is sold – there is no disposal by the Trustees until such time as all of the beneficiaries become entitled to the land (1/2). Therefore, there is no immediate charge to Capital Gains Tax (1/2) and the full gain on the property will be chargeable on 1 December 2027 when Zack turns 25 (1/2). At this point the trustees will only be able to hold over the gain on Zack's share of the gain under s.260 TCGA 1992 (1/2) and CGT will become payable on the gain arising in respect of the other 2/3 attributable to Jessica and William (1/2) as there is no IHT payable on their share at the time that the gain is deemed to arise (1/2)

To mitigate this the trustees should consider advancing Zack's presumptive share of the trust so that they all receive their share at the same time (1/2) triggering a CGT event for all three to coincide with their respective charges to IHT (1/2). This would allow the gain on all three shares of the property to be held over under s.260 TCGA 1992 and there would be no immediate charge to CGT (1/2). Each beneficiary would instead only be liable to CGT when the property is sold (1/2).

Max (13)

Total (20)

3.

As Martha was resident in the UK for at least 10 of the previous 20 years, she will be deemed a long-term UK resident (1/2).She will therefore be chargeable to UK Inheritance Tax on her worldwide assets (1/2).

Julian is not a long-term UK resident as he has only spent six years in the UK from 6 April 2020 to 5 April 2026 (1/2). The spouse exemption is therefore restricted to £325,000, the value of the current nil rate band (1/2)

Potentially Exempt Transfers:

Gift to Julian – 30 April 2020:

	£	£	
Value of Gift (related property)		300,000	½
Less: AE (20/21)		(3,000)	½
Less: AE (19/20)		(3,000)	½
Failed PET		294,000	
Less: Spouse exemption		(294,000)	½
Taxable		£NIL	

Gift to Niece – 1 May 2021:

	£	£	
Value of Gift		175,000	
Less: AE (21/22)		(3,000)	½
Failed PET		172,000	
Less: Nil Rate Band	325,000		½
Less: Previous Transfers	NIL		½
		(172,000)	
Taxable		£NIL	

Gift to Nephew – 1 May 2022:

	£	£	
Value of Gift		175,000	
Less: AE (22/23)		(3,000)	½
Failed PET		172,000	
Less: Nil Rate Band	325,000		½
Less: Previous Transfers	(172,000)		½
		(153,000)	
Taxable		19,000	
IHT @ 40%		7,600	½
Taper Relief (20% x 7,600)		(1,520)	½
IHT due		£6,080	

Death Estate

	£	£	
Free Estate:			
50% share of current Spanish Main Residence	475,000		½
Spouse exemption (£325,000 - £294,000)	(31,000)		½
Chargeable		444,000	
50% share of former UK Main Residence	350,000		
UK Government Gilts	25,000		
UK Bank Accounts	160,000		
UK Quoted Share Investments	230,000		
Loan to brother (resident in Spain)	100,000		
Chargeable		865,000	1
Total chargeable assets		1,309,000	
Less: UK Charitable Donation		(10,000)	½
Less: Costs incurred in Spain			
(475,000 x 5%) (Note 1)		(23,750)	½
Less: Nil Rate Band	325,000		½
Residence Nil Rate Band	NIL		½
Less: Failed PETs (£175,000 = £169,000)	(344,000)		½
Available nil rate band		(Nil)	
Taxable Estate		£1,275,250	
IHT @ 40%		510,100	1
Less: DTR on Spanish property (Note 2)		(95,000)	½
Plus:			
Payable on May 2025 gift to nephew		6,080	½
Total IHT due		£421,180	½

Inheritance tax due on the Spanish residential property(£185,103 - £95,000 = £90,103 (1/2)) is payable by Julian (1/2).

The inheritance tax due on the failed PET (£6,080) is payable by Martha's nephew (1/2)

The Inheritance tax due on the residue of the estate (£510,100 - £185,103 = £324,997 (1/2)) is payable by the executors of Martha's estate (1/2).

All payments are due 6 months following the end of the month of death (31 October 2026) (1/2).

Note 1:

Additional expenses of administering or realising property situated abroad – for example any costs of obtaining foreign probate – are deductible against the death estate (1/2). However, such foreign probate expenses are only allowable up to a maximum of 5% of the value of the foreign assets (1/2).

Note 2:

The amount of double tax relief allowed under s.159 is the lower of:
- the foreign tax suffered £95,000; and
- the UK IHT charged on the foreign asset (1/2).

To calculate the UK IHT charged on the foreign asset:

Estate rate = £510,100 / £1,275,250 x 100 = 40% (1/2).

Tax on Spanish property = £475,000 x 40% = £190,000 (1/2).

Lower value is the foreign tax suffered £95,000 (1/2)

Max (20)

4.

1) Income Tax payable by Cynthia's estate for 2025/26:

	Non-savings	Interest	Dividend	
	£	£	£	
Bank interest (£7,800 + £6,500)		14,300		½
Dividend income			5,000	
ISA interest – exempt as within 3 years of death		-		½
Rental income from investment property: £1,250 x 6 (payments received on 1 July to 1 December) *Cash basis so based on actual receipts until property distributed from estate	7,500			½ ½ ½
Chimney repair cost	(750)			½
Total income	6,750	14,300	5,000	
Tax payable at 20%/20%/8.75%	1,350	2,860	438	1½
Total tax due	4,648			
No tax relief for estate management expenses				½
Total marks for part 1				(5)

2) A Deed of Variation does not have a retrospective effect for Income Tax purposes (1/2). Therefore, any income distributed to Chase before the Deed of Variation was made remains taxable on him (1/2).

Dylan became entitled to any undistributed income at the time of the Deed of Variation as the new beneficiary of the estate (1/2). He also became entitled to any income arising to the estate from the date of the Deed of Variation (1/2). This income is taxable when it is distributed to Dylan (1/2). Any balance of estate income is due to Dylan and taxed at the end of the administration period (1/2).

As Dylan is a minor, Chase is treated as having created a parental settlement for him (1/2). Therefore, Chase will be taxed on any income arising to Dylan from estate assets until Dylan turns 18 (1/2).

Total marks for part 2 (4)

3) Chase is taxable on the distributions made to him before the date of the Deed of Variation (20 January 2026). This therefore includes the Income distribution of £3,000 on 30 September 2025 (1/2) and the distribution of the investment property worth £300,000 on 12 December 2025 (1/2).

The distribution of investment property is treated as a distribution of income in priority (1/2), ie as the value of the investment property exceeds the estate income at the date of the transfer, the amount taxable on Chase is restricted to the income arising.

Total income arising to date of distribution of investment property = bank interest of £7,800 and rental profits of £6,750 (1/2).

Chase's R185 for 2025/26:

	Tax	Net	
	£	£	
Non-savings income	1,350	5,400	½
Interest income	1,560	6,240	½

Dylan is entitled to the income distribution of £4,000 on 18 February 2026, as this was made after the Deed of Variation (1/2).

Dylan's R185 for 2025/26 (taxable on Chase):

	Tax	Net	
	£	£	
Dividend income	384	4,000	½

Total marks for part 3 (4)

4) Capital Gains Tax and Inheritance Tax elections.

As elections have been made, Dylan is deemed to have acquired the estate assets directly from Cynthia under the terms of her Will (1/2).

For Capital Gains Tax purposes, the disposal made by Chase is therefore disregarded (1/2), and Dylan receives the assets with a base cost equal to their probate value (1/2). Any capital gain arising on future disposal will be taxable on Dylan (1/2).

For Inheritance Tax purposes, the transfer of value from Chase to Dylan is also disregarded (1/2).

Total marks for part 4 Max (2)

Total marks for question 4 (15)

5.

	£	£	
1) IHT during lifetime:			
28 September 2015 – gift to Golder Discretionary Trust			
This is a gift to a relevant property trust so is a chargeable lifetime transfer			½
Value of gift		350,000	
Annual exemption 2015/16		(3,000)	½
Annual exemption 2014/15		(3,000)	
Chargeable lifetime transfer		344,000	
Nil rate band at time of gift	325,000		½
Less previous chargeable transfers	nil		½
		(325,000)	
Chargeable to IHT		19,000	
IHT @ 20/80		4,750	½
Gross CLT (344,000 + £4,750)		£348,750	½
There is no CGT payable as cash is not a chargeable asset for CGT.			½
31 May 2022 – gift of boat to son:			
This is a gift with reservation of benefit (GWROB) as Eric continued to use the boat regularly, and he did not pay his son for use of the boat. The gift is a PET, and the boat also remains in Eric's estate for IHT purposes. Double charges relief will apply, and the higher tax position will be taken on Eric's death. For CGT purposes, the gift is exempt as the boat is a wasting chattel.			½ ½ ½ ½ ½
Value of gift		120,000	
Annual exemption 2022/23		(3,000)	½
Annual exemption 2021/22		(3,000)	
PET		114,000	
13 December 2022 – gift of cash to daughter:			
The gift of cash is a PET. The GWROB rules do not apply as it is a gift of cash. Instead, the Pre-Owned assets (POAT) rules apply to this gift because Eric directly provided cash to his daughter which she used to acquire a property from which Eric benefitted. Eric will have a POAT charge equal to the annual rental value of £28,800 per annum, which should have been included on his self-assessment tax returns. He has made no rental payments to reduce this charge.			½ ½ ½ ½ ½ ½
Value of gift		480,000	
Annual exemption 2022/23 & 2021/22 – used		-	½
PET		480,000	
There is no CGT payable as cash is not a chargeable asset for CGT.			PAG
Total marks for part 1		Max	(9)
2) IHT as a result of death:			

Calculation 1:			
28 September 2015 – gift to Golder Discretionary Trust			
More than seven years before death so no additional IHT due			½
31 May 2022 – gift of boat to son			
Tax PET, ignore GWROB:			
PET		114,000	
NRB	325,000		
CLT in seven years before gift (see above)	(348,750)		½
		-	
Taxable		114,000	
IHT @ 40%		45,600	½
Taper relief 3-4 years @ 20%		(9,120)	½
IHT payable		£36,480	
13 December 2022 – gift of cash to daughter			
PET		480,000	
NRB	325,000		
Less transfers in previous seven years	(114,000)		½
Available NRB		(211,000)	
		269,000	
IHT @ 40% (no taper as within 3 years of death)		£107,600	½
Death Estate:			
Chargeable estate (excluding value of GWROB)		695,000	
NRB	325,000		
Less transfers in previous seven years	(594,000)		½
Available NRB		-	
Taxable estate		695,000	
IHT @ 40%		£278,000	½
Total IHT calculation 1 (£36,480 + £107,600 + £278,000)		£422,080	
Calculation 2:			
28 September 2015 – gift to Golder Discretionary Trust			
More than seven years before death so no further IHT due			PAG
31 May 2022 – gift of boat to son			
Tax GWROB, ignore PET		-	
13 December 2022 – gift of cash to daughter			
PET		480,000	
NRB	325,000		
Less transfers in previous seven years	nil		½
Available NRB		(325,000)	
		155,000	
IHT @ 40% (no taper as within 3 years of death)		£62,000	½
Death Estate:			
Chargeable estate (including value of GWROB)		835,000	½

NRB	325,000		
Less transfers in previous seven years	(480,000)		½
Available NRB		-	
Taxable estate		835,000	
IHT @ 40%		£334,000	½
Total IHT calculation 2 (£62,000 + £334,000)		£396,000	
Calculation 1 produces the higher tax result; therefore, the original PET remains in charge and the boat is not included in the death estate.			½
Total marks for part 2			(7)

3) If Eric had stopped using the boat in September 2023, he would have released the gift with reservation at that time and would be deemed to have made a PET (1/2) of £130,000 (1/2). Eric would not be able to use any annual exempt amounts available to him against this deemed PET (1/2).

The boat would no longer be charged in Eric's death estate (1/2), instead the double charges relief rules would apply to compare the two PETs (1/2). One calculation would include the original gift made in May 2022, and one would include the deemed PET on release of the GWROB in September 2023 (1/2). The calculation producing the higher IHT amount would be used by HMRC (1/2).

Total marks for part 3 — Max (2)

4) There are a number of actions to be taken as a member of The Association of Taxation Technicians (ATT), upon discovering the POAT charge was not included on Eric's tax return to the date of his death.

The member is not required to make enquiries to identify errors on Eric's tax return to the date of his death (1/2), as this is not within the scope of the Inheritance Tax work they are engaged to complete (1/2). However, once the member is aware of the error made by Hills LLP in completing the 2025/26 tax return (and presumably for earlier years from the date of the gift during 2022/23), they have a duty to inform their client, being the Executors of Eric's estate (1/2), as soon as possible (1/2).

The member should consider that the Executors may not be aware of all the facts and the circumstances of how the error arose (1/2).

The member owes a duty of confidentiality (1/2) to the Executors as their client not to disclose client information to a third party without the client's proper and specific authority (1/2). The member should therefore seek the Executors' authorisation to disclose their findings to Hills LLP (1/2) to enable them to correct the error (1/2).

The member could also consider asking for permission to contact HMRC directly to disclose the error on the Executors' behalf (1/2).

If permission is not given in either case, the member should consider whether it is appropriate to continue to act for the Executors (1/2).

The member should keep written records of all conversations they have with the client (1/2).

The member should also consider whether the error has any impact on the work they have been engaged to complete (1/2). In this case, any additional unpaid Income Tax would be a liability of the estate (1/2), and so will affect the value of the death estate subject to Inheritance Tax (1/2).

Total marks for part 4 — Max (5)

Total marks for question 5 **(23)**