



July 2026 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Suggested Answers

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

1.

As Amanda has been resident in the UK for at least 10 out of the previous 20 tax years she is a long-term UK resident (1/2), and will be subject to UK Inheritance tax on her worldwide assets (1/2).

IHT on estate before any reliefs:			
	£	£	
Main Residence	525,000		½
Rental Property	260,000		
Cash	55,000		
Quoted Shares (W1)			
X Plc: (178 x 200)	35,600		½
Y Plc: (56 x 400)	22,400		½
Z Plc: (79 x 100)	7,900		½
Unit Trusts (W2) (122 x 3,500)	427,000		½
Charitable Legacy (N1)	(NIL)		½
		1,332,900	
Less: Nil Rate Band/Transferable Nil Rate Band (N2)	325,000		½
Less: Residence Nil Rate Band/Transferable Residence Nil Rate band (N3)	(NIL)		½
Chargeable transfers in 7 years before death	(NIL)		½
		(325,000)	
Taxable Estate		£1,007,900	
Tax @ 40%		403,160	½
Less: DTR (W3)		(78,642)	½
Inheritance Tax due		£324,518	½

Inheritance tax is payable by the executors (1/2) by 30 November 2026 (1/2).

(N1) The charitable legacy to the Spanish cat rescue does not qualify for relief as it is not a UK registered charity.

(N2) The transferable nil rate band is not available as Amanda has never been married.

(N3) The residence nil rate band/transferable residence nil rate band is not available as Amanda has never been married and the estate is not passing to her lineal descendants.

(W1)

For Inheritance Tax, quoted shares are valued at the lower value* using the “quarter up rule” taking the bid price and adding a quarter of the offer price less the bid price and the “average bargain rule” taking the average of the highest and lowest marked bargains (1/2).

	Average Bargain rule	Quarter Up rule	
X Plc	$(175+182)/2 = 178.5$	$(181-177)/4 + 177 = 178^*$	1
Y Plc	$(52+60)/2 = 56^*$	$(61-56)/4 + 56 = 57.25$	1
Z Plc	$(75+83)/2 = 79^*$	$(83-78)/4 + 78 = 79.25$	1

(W2)

For Inheritance Tax purposes, unit trusts are valued using the bid price which is the lower of the quoted prices (1/2).

ABC Unit Trust = 122 (1/2).

(W3)

Double Tax Relief is available at the lower of:

- UK IHT due on rental property
 $(260,000 / 1,332,900) \times 403,160 = \text{£}78,642$ (1/2)

And

- Spanish IHT paid - £80,000

Max (13)

2)

Where quoted shares or unit trusts are sold by the executors of an estate within 12 months of death for a loss (1/2), post-mortem relief is available to substitute the probate value with the lower sales proceeds in the death estate (1/2).

Executors must consider all share sales in the 12 months following death, even if these were at a profit (1/2). No relief is given for costs of sale (1/2).

	£	£	
31 July 2026 – sale of X Plc shares			
Gross Proceeds	15,000		
Probate Value (100/200 x 35,600)	(17,800)		1/2
Loss		(2,800)	
30 September 2026 – sale of Y Plc shares			
Gross Proceeds	20,600		
Probate Value (300/400 x 22,400)	(16,800)		1/2
Profit		3,800	
31 March 2027 – sale of ABC unit trust			
Gross Proceeds	95,000		
Probate Value (1,500 / 3,500 x 427,000)	(183,000)		1/2
Loss		(88,000)	
30 June 2027 – sale of Z Plc shares			
More than 12 months since Amanda's death so no relief is available			1/2
Aggregated Loss		£(87,000)	1/2
Restriction for shares purchased by executors:			1/2
	£	£	
1 August 2026 – 12,000 shares in W Plc			1/2
Purchase cost	50,000		
Restriction $(50,000 / (15,000 + 20,600 + 95,000)) \times 87,000$		33,308	1
1 June 2027 – 1,000 shares in V Plc			
No restriction as more than 2 months following the sale of shares in ABC Unit Trust (the last holding taken into account for post-mortem relief)			1/2
S.179 IHTA 1984 loss		£(53,692)	1/2
IHT payable after post-mortem relief			
	£	£	
Previous total estate after NRB	1,007,900		
Less: post-mortem loss	(53,692)		1/2
Taxable Estate		954,208	

Tax @ 40%		381,683	½
Less: DTR (W4)		(74,452)	1
Inheritance Tax due		307,231	
Therefore, repayment due (324,518 – 307,231)		£17,287	½

(W4) Double Tax Relief is available at the lower of:

- UK IHT due on rental property

$$(260,000 / 1,332,900) \times 381,683 = £74,452$$

And

- Spanish IHT paid - £80,000

[N.B. Candidates shortcutting this calculation to $£53,692 \times £324,518 / £1,007,900 = £17,287$ will get equivalent marks awarded.]

(10)

Total (23)

2.

1) IHT payable by trustees on capital distributions:

	£	£	
Initial gift to the trust			
1 March 2018 – gift to The Relay Life Interest Trust			
This is a gift to a relevant property trust so is a chargeable lifetime transfer			½
IHT payable on gift to the trust:			
Value of gift:			
Cash	350,000		
Farmland	450,000		
APR @ 100% on the agricultural value (see below)	(350,000)		½
BPR @ 50% on the excess value above agricultural value (see below)	(50,000)		½
Bolt Ltd shares (see below)	700,000		
BPR @ 100% on Bolt Ltd shares	(700,000)		½
Chargeable lifetime transfer		400,000	
Nil rate band at time of gift	325,000		½
Less previous chargeable transfers	nil		½
		(325,000)	
Chargeable to IHT		£75,000	
IHT @ 20% (trustees paying the tax)		£15,000	½
Farmland:			
APR is available at 100% as the land is used by a partnership of which Malcolm is a partner and Malcolm has owned it for the requisite two years.			½
BPR is available at 50% as the land is used by a partnership of which Malcolm is a partner and Malcolm has owned it for the requisite two years.			½
Bolt Ltd shares:			
As Malcolm continues to own shares, we must use the loss to donor rules:			

Value of Malcolm's shares prior to transfer 1,000 x £800	800,000		½
Value of Malcolm's shares after transfer 400 x £250	(100,000)		½
Loss to Malcolm's estate	700,000		
BPR is available at 100% as the shares are in an unquoted trading company and Malcolm has owned them for the requisite two years			½
<u>Initial value of trust</u>			
Initial value is based on the stand-alone value of the assets immediately after they are comprised in the settlement and ignores APR/BPR			½
Cash	350,000		
Farmland	450,000		
Shares – 600 x £500	300,000		½
IHT borne by the trustees	(15,000)		½
	1,085,000		
<u>Exit charges</u>			
Initial value of trust property	1,085,000		
Initial value of relevant property in a related trust	-		½
		1,085,000	
Nil rate band at date of exit	325,000		½
Less Malcolm's CLT's in 7 years before trust	-		½
		(325,000)	
		760,000	
Notional IHT @ 20%		152,000	½
Effective rate: 152,000 / 1,085,000		14.009%	½
Actual rate of tax: 14.009% x 30% x 20/40		2.101%	½
(1 March 2018 – 23 May 2023 = 20 quarters)			½
Gross up rate of tax as trustees are paying IHT: 2.101/(100-2.101) x 100		2.146%	½
IHT on cash distribution: £50,000 x 2.146%		1,073	½
Distribution of Bolt Ltd shares:	180,000		
BPR is available on the exit as the trustees have held the unquoted trading company shares for more than 2 years.			½
BPR @ 100%	(180,000)		½
Taxable exit		nil	
Farmland distribution:	300,000		
APR is available on agricultural value of the distribution as the land has been owned by the trustees and tenanted for more than 7 years. The lease was signed after 1 September 1995 therefore the rate of relief is 100%			½
			½
APR @ 100%	(250,000)		½
Taxable exit		50,000	

Rate of tax: 4.203% x 28/40 (1 March 2018 – 4 April 2025 = 28 quarters)		<u>2.942%</u>	$\frac{1}{2}$
Gross up rate of tax as trustees are paying IHT: $2.942/(100-2.942) \times 100$		<u>3.031%</u>	$\frac{1}{2}$
IHT £50,000 x 3.031%		<u>1,516</u>	$\frac{1}{2}$
		<u>Max</u>	<u>(12)</u>

2) The CGT implications of the capital distribution of the farmland:

The distribution of the farmland is a chargeable transfer for CGT (1/2). A capital gain will arise to the trustees, calculated as the market value of the land at the date of distribution (£300,000) (1/2), less the trustees' base cost. The base cost is calculated as a part disposal, i.e., $\text{£}450,000 \times 300,000 / (300,000 + 300,000) = \text{£}225,000$ (1/2).

The trustees are able to claim an annual exemption equal to half of an individual's annual exemption, on the basis that Malcolm has not created any other settlements (1/2). The resulting capital gain will be taxed at 24% (1/2).

The trustees could make a claim for gift relief (1/2) because there is an immediate charge to IHT (1/2). This claim would need to be made jointly with the beneficiary receiving the farmland (1/2). This would defer the capital gain by reducing the base cost of the farmland in the beneficiary's hands by the value of the gain (1/2).

Total marks for part 2

Max (3)

3) Incorrect advice received from previous adviser:

Malcolm is entitled to make a complaint to his previous adviser for the incorrect advice he received (1/2).

Quick Tax LLP should acknowledge the complaint promptly in writing (1/2) and ensure that an investigation of the complaint takes place by a person with suitable experience thoroughly and without delay (1/2). They should also consider taking legal advice (1/2) and notifying the matter to their professional indemnity insurers (1/2).

If Malcolm's complaint is found to be justified, as would be expected in this instance (1/2), Quick Tax LLP should acknowledge this, apologise (1/2) and take appropriate action (1/2).

If Malcolm is not satisfied with this response, he could make a claim for professional negligence against Quick Tax LLP (1/2).

Malcolm could also refer the complaint to the Taxation Disciplinary Board (TDB) for independent investigation (1/2). If he does so, Quick Tax LLP would need to evidence to the TDB how the complaint has been dealt with (1/2).

Total marks for part 3

(Max 5)

Total marks for question 2

(20)

3.

1) Residence position of the Festiva Discretionary Trust

To establish the residence position of the trust first the residence status of the trustees must be considered. If both trustees (1/2) were UK resident in the year, then the trust is UK resident (1/2). As Rio's brother is UK resident and his sister is non-UK resident, this is not the case.

Rio's position as settlor must be considered (1/2). If at least one trustee is UK resident (1/2) and Rio as settlor UK resident at the time he created the trust (1/2), the trust is UK resident. As Rio and his brother were UK resident at the relevant times the trust is UK resident. (1/2)

Total marks for part 1

Max (2)

2) Festiva Trust income tax calculation for 2025/26

	Non-savings	Interest	Dividend	
	£	£	£	
UK bank interest		6,700		1/2
Dividend income			23,000	
Utopian bank interest		4,200		1/2
Rental income from London investment property: £1,450 x 12	17,400			1/2
Rental income from overseas investment property: £1,300 x 2 (payments received on 1 May and 1 June 2025) *Cash basis so based on actual receipts until property sold	2,600			1/2 1/2
Total income	20,000	10,900	23,000	
Trust management expenses: £1,460 x 100/91.25			(1,600)	1
*Deemed to come from dividends in priority to saving and non-savings income				1/2
Income after expenses	20,000	10,900	21,400	
Tax payable at 45%	9,000	4,905		1
Tax payable at 39.35%			8,421	1/2
Tax payable at 8.75%: £1,600 x 8.75%			140	1/2
Total	22,466			
Add tax pool charge (see below)	1,794			1/2
Total income tax payable for 2025/26	24,260			
Tax pool workings:				
Balance brought forward on 6 April 2025	425			1/2
Add tax paid in year* £9,000 + £4,905 + £8,421	22,326			1/2
Less tax credits on distributions to beneficiaries: £10,000 x 3 x 45/55	(24,545)			1
Balance = tax pool charge	(1,794)			
* Does not include tax on dividend income used to pay expenses				1/2
R185 (identical for each beneficiary)	Net	Tax		
	£	£		
Trust income	10,000	8,182		1
Total marks for part 2				(10)

3) Festiva Trust Capital Gains Tax calculation for 2025/26

	£	£	
Gains in year on disposal of Investment shares:			
Proceeds	18,000		
Base cost	(14,000)		
Capital gain		4,000	½
Gain on disposal of Overseas property:			
Proceeds	260,000		
Base cost	(219,000)		
Capital gain		41,000	
Brought forward losses - £1,000		(1,000)	½
Annual exemption for trusts = £1,500		(1,500)	½
Chargeable Gains		£42,500	
CGT payable by the trustees at 24% for 2025/26		£10,200	½
Total marks for part 3			(2)

4) Capital Gains Tax on distribution of apartment to Rio

As Andre is a beneficiary of the trust and has been allowed to occupy the apartment as his main residence (1/2), the trustees are able to claim Private Residence Relief (PRR) on the disposal (1/2). This means that the period Andre occupied the apartment (1/2), and the last 9 months of ownership are exempt periods for PRR (1/2).

The period in which Andre worked in Brazil will also count as an exempt period for PRR, as it qualifies as any period of employment overseas (1/2), as long as he reoccupies the apartment before it is distributed to him (1/2). If Andre does not reoccupy the apartment, then his absence cannot be counted as an exempt period for PRR (1/2).

Chargeable capital gains:

Total period of ownership: 1 July 2022 – 1 October 2026 = 4.25 years			½
	Occupation/deemed occupation	Absence	
If distributed before Andre returns to live in the property:			
1 July 2022 – 31 December 2022		0.5	
1 January 2023 – 31 December 2024	2		PAG
1 January 2025 – 31 December 2025		1	PAG
1 January 2026 – 1 October 2026	0.75		PAG
Totals:	2.75	1.5	½
Capital gain	70,000		
PRR if distributed before Andre returns: £70,000 x 2.75/4.25	(45,294)		½
Chargeable gain before annual exempt amount	£24,706		

If distributed after Andre returns to live in the property:			
1 July 2022 – 31 December 2022		0.5	
1 January 2023 – 31 December 2024	2		PAG
1 January 2025 – 31 December 2025	1		PAG
1 January 2026 – 1 October 2026	0.75		PAG
Totals:	3.75	0.5	½
Capital gain	70,000		
PRR if distributed after Andre returns: £70,000 x 3.75/4.25	(61,765)		½
Chargeable gain before annual exempt amount	£8,235		
Total marks for part 4			(6)

Total marks for question 3

(20)

4.

1)

National Heritage property is given a “conditional exemption” from Inheritance Tax (½).

The gift of the Grade II listed property to James by Richard during his lifetime is a Potentially Exempt Transfer (PET) chargeable on his death within seven years as a failed PET (½).

For lifetime gifts to qualify for the exemption, it must be agreed by HMRC that the property is heritage property at the date of the donor's death (½) and the property must originally have been owned by the donor for six years prior to the lifetime gift (½) or inherited by the donor under the conditional exemption (½).

The exemption is not available if the asset is sold by the donee before the donor's death (½).

As James retained the property at the date of Richard's death, and Richard held it for more than six years before gifting it to James, then this will qualify for the exemption provided there is an agreement with HMRC that the property is heritage property (½). The claim for the exemption must be made by James as the donee (½) within two years of the death of the donor (Richard) (½).

The gift of the heritage property in lifetime is on a “no gain, no loss” basis for Capital Gains Tax purposes, so there is no immediate charge to Capital Gains Tax (½). James' base cost for the property is therefore:

	£	
Acquisition Cost	500,000	½
Improvements	150,000	½
Base Cost	650,000	

For the property to qualify for this exemption James must agree to the following conditions:

- The property must be open the asset for public viewing (½) for at least one month a year (½)
- James must publicise that the property is available for viewing (½)
- The property must be maintained and preserved by James (½)

Where the National Heritage property is part of the donor's death estate, such as the vase, no Inheritance Tax is due on the value of the heritage property, providing the above conditions for exemption are met (½). A claim for exemption must be made by the executors within two years of Richard's death (½).

For movable property, such as the vase, the property must also remain in the UK to qualify for the exemption (½)

Max (9)

2)

On Richard's death the gift of the shares to James becomes chargeable. The value of the transfer is usually the value at the time of the gift ie £480,000 (½) reduced by the two available annual exemptions totalling £6,000. (½)

However as the value of the shares decreased, James, as the donee, (½) is able to make a claim for Fall In Value (FIV) relief. (½)

The FIV relief is usually the difference between the value of the shares at the date of the gift ie in May 2023 (£480,000) and the value at the date of Richard's death (£403,000). (½) However as James sold the shares before Richard's death the FIV relief is the difference between the value at May 2023 and the gross sale proceeds of £415,000. (½) So the relief is £65,000 (£480,000 - £415,000). (½)

The claim must be made within four years of Richard's death, i.e. by 1 May 2029 (½).

The IHT on death will be as follows:

	£	
Original value at date of transfer	480,000	($\frac{1}{2}$)
Less annual exemptions	(6,000)	($\frac{1}{2}$)
Less Fall in Value relief	(65,000)	($\frac{1}{2}$)
Less: NRB	(325,000)	($\frac{1}{2}$)
Taxable amount	84,000	
Tax @ 40%	£33,600	($\frac{1}{2}$)

Therefore, the claim will reduce the IHT payable by James by £26,000 (£65,000 x 40%) ($\frac{1}{2}$).

Max (6)

Total (15)

5.

X May 2026

Our ref: xxx123

Tax Advisor

Tax Firm

Address

Post Code

Dear Mr & Mrs Brown

FUNDING GRANDCHILDREN'S SCHOOL FEES

I write to review the options in relation to the funding of your grandchildren's school fees. Following our meeting, I understand you are considering three options:

1. Outright gifts from capital on a termly basis to your grandchildren to cover their school fees:

The gift of cash to your grandchildren would be treated as Potentially Exempt Transfers (PETs) for Inheritance Tax purposes ($\frac{1}{2}$). This means there is no immediate charge to Inheritance Tax ($\frac{1}{2}$).

If you die within seven years of making the PETs, these will be brought into charge for Inheritance Tax purposes ($\frac{1}{2}$). If the gifts are made within four years of death, there may be an element of taper relief available against the Inheritance Tax arising on these gifts to the extent that they exceed your respective nil rate bands ($\frac{1}{2}$). Any Inheritance Tax arising would be payable by your grandchildren who may not have the funds to do so ($\frac{1}{2}$). To the extent that the failed PETs fall within your nil rate bands it will be your respective estates that will bear the

Inheritance Tax out of residue because the lifetime gifts use up your nil rate bands in priority to the death estate (½).

Given that your grandchildren are still young and have many years of education left you will be making gifts for several years, which will inevitably mean that at least some of these gifts may fall within the seven-year cumulation period above (½)

As you have stated that these gifts will be partly from sales of investments from your quoted investment portfolio there is likely to be Capital Gains Tax implications on the sale of your investments unless these are invested in ISAs (½).

To the extent that the gifts are from income from your quoted investment portfolio, it is possible that these may qualify as regular gifts out of excess income which are exempt from Inheritance Tax (½). These gifts must be made from income (½) which they would be, and you must ensure that you retain the same lifestyle before and after the gifts are made, i.e., the income must be surplus to your requirements (½). In addition, these gifts must be intended to be made on a regular basis which given that they are termly this would apply (½).

2. Providing a lump sum to be held under bare trust:

As above, the gift of cash to your children, to be held on bare trusts for your grandchildren until they reach majority, would be Potentially Exempt Transfers (PETs) (½).

Any Inheritance Tax arising whilst the grandchildren are under 18 years will be payable by their parents on their behalf as trustees of the bare trust out of the trust funds and by themselves after that (½).

As the gift is to be made of a single lump sum payable up front this reduces your/your grandchildren's exposure to Inheritance Tax as this starts the seven-year clock immediately (½).

As you are gifting cash, this is outside the scope of Capital Gains Tax, and therefore there would be no immediate CGT charge (½).

As the assets will be held under bare trust, any income generated by the managed investments will be taxable to Income Tax directly on your grandchildren (½). They will have the benefit of their personal allowances against this income if it isn't already used elsewhere (½). Similarly, any capital gains will be subject to Capital Gains Tax directly on your grandchildren, after the deduction of their annual exemption (½).

3. Settling a lump sum payment into a discretionary trust:

Settling a lump sum of cash/investments onto a discretionary trust is a chargeable lifetime transfer (CLT) (½). To the extent this transfer exceeds your nil rate bands, after taking into consideration any other chargeable lifetime transfers in the previous seven years (PAG), the balance will be immediately chargeable to Inheritance Tax at 20% (½).

If you die within seven years of the CLT, this will incur a further charge on death for Inheritance Tax purposes (½). If the gift is made within four years of your death, there may be an element of taper relief available against the additional Inheritance Tax charged on the gift (½) and credit would be given for any lifetime Inheritance Tax already paid (½).

If you are gifting cash, this is outside the scope of Capital Gains Tax, and therefore there would be no immediate CGT charge (PAG). If you are gifting investments, these will be deemed to be transferred at market value, and if this gives rise to a gain you will be liable for a charge to Capital Gains Tax (PAG). As the settlement of funds into a discretionary trust is a chargeable event for Inheritance Tax purposes, any gain arising on the transfer of investments may be held-over under s.260 TCGA 1992 (½), allowing the settlor to make an election to defer the Capital Gains liability until the sale of the investments within the trust by the trustees (½) or until these are transferred out to the beneficiaries on reaching age 25 or on an earlier capital distribution (½).

Any income generated within the Trust would be taxable on the trustees at the rate applicable to trusts (RAT) which is the same as the additional rate for individuals being 45% for non-savings and savings income and 39.35% for dividend income (½). Any capital gains generated within the trust would also be subject to Capital Gains at the higher rate of 24% (½), after deduction of the CGT annual exemption, which is half that of an individuals' (½).

When the beneficiaries require funds from the trust, there will be a distribution from the Trust (½). If this is an income distribution, this will be distributed with a 45% tax credit for tax paid in the trust (½) which can be reclaimed if the individuals' marginal rate is lower than that of the trust (½). If the distribution is from capital funds, this will give rise to an Inheritance Tax exit charge (½).

If you are distributing cash, this is outside the scope of Capital Gains Tax, and therefore there would be no immediate CGT charge on the distribution (PAG). If you are distributing investments, then there will be a charge to Capital Gains Tax as on entry into the trust (above) (½) with the same availability of hold-over relief under s.260 TCGA 1992 (½) any claim for which would need to be made jointly by the trustees and the recipient beneficiary (½).

Recommendation

As CLTs and PETs come back into charge if you die within seven years, it is advisable to make these gifts as soon as possible (½).

I would recommend making outright gifts out of your excess income as far as possible to minimize overall Inheritance Tax Implications (½) with any further funds required being made as an upfront lump sum to either a bare trust or a discretionary trust (½).

If you would like these funds to be protected, or to retain control over their distribution this should be made into a discretionary trust as with a bare trust your grandchildren will gain control of the remaining assets at the age of 18 (½).

If your grandchildren have no other income, it would be beneficial for them to hold the assets in a bare trust to make immediate use of their personal allowances and annual exemptions rather than waiting for an income distribution (½).

In addition, if the amount in the initial transfer is greater than your nil-rate band, transferring these into a bare trust would be a PET, rather than a CLT which would remove the immediate charge to Inheritance Tax providing you lived for seven years from the date of the gift (½).

I hope this letter lays out some of the main tax points in relation to your query and I look forward to discussing this in due course.

**Credit will be given for any other valid points made by candidates*

Kind regards,

Tax Advisor

Total (20)