



Practical Tax People  

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Association of  
Taxation Technicians

## **May 2017 Examination**

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### **PAPER 5**

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### **Inheritance Tax, Trusts & Estates**

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Part II Suggested Answers

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1.

1) Exit charge

Effective rate of tax at previous 10 year anniversary 14.15%

NB No change in nil rate band since previous 10 year anniversary, therefore use same effective rate.

	£	£	
Value of assets distributed:			
Shares in Widget plc (a 5% holding)	153,000		}
Unit 6, Enterprise Park	375,000		} <sup>1/2</sup>
Seaview Cottage	295,000		}
Cash: (£600,000 - £95,000)	<u>505,000</u>		} <sup>1/2</sup>
		1,328,000	

Actual rate:  
14.15% x 30% 4.245% 1

Inheritance Tax arising:

£1,328,000 x 4.245% x 19/40\* 26,777 1/2

\* Quarters between 10 year anniversary and distribution -  
29 November 2011 – 28 November 2016 = 19 complete quarters 1/2

NB Rates of tax to 3dp. Credit given for other rounding.

**Total marks for part 1 (3)**

2) Form IHT 100 (1/2)  
31 May 2017 (1/2)

**Total marks for part 2 (1)**

3) Capital Gains on distributions

	£	£	
<b>Widget plc shares</b>			
Value at distribution	153,000		
Purchase cost	<u>(85,000)</u>		
Capital Gain		68,000	1/2
<b>Unit 6, Enterprise Park</b>			
Value at distribution	375,000		
Purchase cost	<u>(322,000)</u>		
Capital Gain		<u>53,000</u>	1/2
Gains taxable at 20%		<u>121,000</u>	
CGT at 20%: £121,000 x 20%		<u>24,200</u>	1/2
<b>Seaview Cottage</b>			
Value at distribution	295,000		
Purchase cost	<u>(250,000)</u>		
Capital Gain	45,000		1/2
PPR Relief*	<u>(30,600)</u>		
Chargeable Gain		14,400	
Annual exemption 2016/17 – deducted against gain liable to highest rate of CGT		<u>(5,550)</u>	1

Gains taxable at 28%	<u>8,850</u>	
CGT at 28%: £8,850 x 28%	<u>2,478</u>	½
Total CGT payable (24,200 + 2,478)	<u>26,678</u>	
*PPR Relief:		
Beneficiary occupied as main residence: 29 January 2014 – 28 November 2016 = 34 months		½
Not occupied by beneficiary as main residence: 29 September 2012 – 28 January 2014 = 16 months		½
PPR Relief = £45,000 x 34/(34 + 16) = £30,600		½
NB Cash is not a chargeable asset for CGT purposes		
<b>Total marks for part 3</b>		<b>(5)</b>

- 4) Holdover relief would be available (under s260 TCGA 1992) as the distribution is a chargeable transfer for Inheritance Tax purposes (1).

When a claim for holdover relief is made, the gain is effectively “rolled over”, and reduces the base cost of the asset in the hands of the beneficiary (½) which is likely to lead to a larger gain being triggered on a future disposal of the same asset (½).

If a claim for holdover relief was made in respect of the property used as a main residence by a beneficiary, this would prevent the beneficiary claiming PPR Relief on the future disposal of this property (1).

*Credit will be given for other valid comments.*

**Total marks for part 4** (3)

- 5) A letter of disengagement should address the following matters:

- A summary of services provided up to the date of ceasing to act (1)
- A note of any further action to be taken by the member (1)
- A note of any outstanding matters that either the ex-client or the new advisers will need to address (1)
- Details of any impending deadlines and the action required (1)
- The member’s willingness or otherwise to:
  - assist the new advisers to resolve outstanding issues with HMRC or others (1)
  - provide copy papers to the new advisers (1)
- Details of any outstanding fees (1)
- A note indicating whether the member or his successor is to advise HMRC of the change. (1)

Any three of the above.

**Total marks for part 5** MAX (3)

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

2.

1) To calculate the Inheritance Tax 10 year charge, the following information is required:

- The value of the shares and cash held as capital at the 10 year charge date (1)
- The market value of the property, less the outstanding mortgage at the 10 year charge date (1)
- Details of any chargeable transfers made by James in the seven years before he created the trust (1)
- Any capital distributions that were liable to exit charges in the 10 years prior to the 10 year charge date (1)
- The nil rate band at the date of the ten year charge (1)
- Whether all the trust fund has been relevant property for the full ten years prior to the 10 year charge date (eg has property been added, or income accumulated to capital since commencement) (1)
- Details of whether any of the property is eligible for Inheritance Tax relief eg business property relief or agricultural property relief (1)
- Any income in the trust at the 10 year charge date that arose more than 5 years prior to that date. (1)

Any five of the above.

Total marks for part 1 MAX (5)

2) The trustees could invest in assets which qualify for Business Property Relief (BPR), such as:

- Any number of shares in unlisted trading companies (1/2)
- Controlling shareholdings in quoted trading companies (1/2)
- A trading business (1/2)
- An interest in a trading partnership. (1/2)

Once the asset qualifying for BPR has been held for two years (1/2), the transfer of value on the 10 year anniversary will be reduced by the BPR available on the BPR assets (1/2).

*Credit will be given for other valid comments.*

Total marks for part 2 (3)

3) An exit charge does not arise when:

- trustees make income distributions (1)
- trustees distribute capital within a quarter (ie 3 months) of the trust being set up (1/2) or within the quarter after a 10 year anniversary (1/2).
- trustees distribute excluded property. (1)

Any two of the above.

Total marks for part 3 MAX (2)

4) There are no Inheritance Tax consequences of converting the trust from a discretionary trust to an IIP (1/2) as the trust assets will remain part of the relevant property regime (1/2).

There are also no Capital Gains Tax consequences of converting the trust (1/2) as the conversion itself would not result in a capital gains tax disposal (1/2).

There are no immediate Income Tax consequences of converting the trust as this is not a chargeable event for income tax purposes (1).

*Credit will be given for other valid comments.*

**Total marks for part 4 (3)**

- 5) Trustees can vary the terms of a trust if the trust deed contains appropriate powers (1) otherwise a trust may only be varied by an application to the court (1).

**Total marks for part 5 (2)**

**Total marks for question 2 (15)**

3.

[Adviser's address]

[Client's address]

[Date]

Dear Mr Patel

Thank you for your queries which I have responded to below.

1) The estate's Income Tax liability

Income which is received by the estate after your father's death will be taxed at basic rates (1/2), and no relief is available for expenses incurred in managing the estate (1/2). Unlike for individuals, there is no tax free personal allowance available when calculating the Income Tax liability (1/2). There is, however, relief available for interest on a loan taken out in order to pay the Inheritance Tax liability, (1/2) provided the interest is paid within 12 months of the loan being taken out. (1/2)

*Credit will be given for other valid comments.*

Presentation mark (1)

**Total marks for part 1 MAX (3)**

2) Relief for the capital loss

As the Executors have sold quoted shares and have made a net loss, it is possible to claim Inheritance Tax relief for this loss (1/2). Please note you should calculate the allowable loss by taking into account all sales of quoted shares in the 12 month period from the date of death (1/2), and aggregating all profits and losses in order to calculate the net loss position (1/2). Gross sale proceeds must be used, so it is not possible to take expenses of sale into account when calculating the allowable loss (1/2).

The relief is given by the executors making a claim (1/2) to reduce the value of the death estate by the amount of the allowable capital loss (1/2). If the Inheritance Tax liability has already been paid, this should result in a repayment of some of the Inheritance Tax (1/2). The revised lower value of the shares included in the death estate will become the new base cost for Capital Gains Tax purposes (1/2).

*Credit will be given for other valid comments.*

Total marks for part 2

MAX (3)

### 3) "Simple" estates for Income Tax and Capital Gains Tax

You are quite right that there are special provisions for certain estates. These provisions enable the executors to submit a single Income Tax and Capital Gains Tax computation, together with an informal payment of the total tax liability for the entire administration period.

The conditions for these provisions to apply are as follows:

- The total income tax and capital gains tax liability (1/2) for the administration period is less than £10,000 (1/2)
- the administration is completed within 2 years of the date of death (1/2)
- The probate value of the estate is less than £2.5m (1/2)
- The proceeds of assets sold in any one tax year are less than £250,000 if the death occurred prior to 6 April 2016 (1/2) or less than £500,000 if the death occurred after 5 April 2016 (1/2)
- The estate is not regarded as complex. (1/2)

Total marks for part 3

Max (3)

### 4) Your draft will

You have queried what is required for a will to be formalised. For a will to be valid, the following requirements must be met:

- It must be in writing (1/2)
- It must be signed by the testator (1/2)
- The testator's signature must be witnessed by two persons who are present together when the testator signs the will (1/2). The witnesses must then each sign the will in the presence of the testator and of each other (1/2)
- The testator must be sui juris (over 18 and have mental capacity) (1/2)
- The testator must intend the will to be operative as a testamentary disposition (1/2)
- The will should be dated. (1/2)

*[Scottish alternative*

*For a will to be valid:*

- *It must be in writing (1/2)*
- *It must be subscribed by the testator (1/2)*
- *It must be signed at the end (1/2)*
- *However, if it is witnessed by one witness and if it extends over more than one sheet, each sheet is signed by the testator, the will is also presumed to be validly signed (1)*

- The testator must comprehend the nature of the testamentary act. (1/2)
- The testator must be at least 12 years old. (1/2)]

Total marks for part 4

(3)

5) Tax payment reminders

As a member of the Association of Taxation Technicians I am required to maintain a diary system to ensure that I give you warning of all relevant due dates for payments of tax (1).

I am responsible for keeping the trustees informed of the amount of tax due for payment (1), the due date for payment (1) and will also remind you of the fact that interest accrues from that date (1).

*Credit will be given for other valid comments.*

Total marks for part 5

MAX (3)

I hope the above information answers your queries and please get in touch if you require anything further.

Kind regards

Tax Adviser

Total marks for question 3

(15)

4.

1) 2016/17 Income Tax payable by the Potter Discretionary Trust

The Income Tax payable by the trust is calculated as set out below.

	Non-savings £	Dividends £	
Net rental income (24,000 – 3,000)	<u>21,000</u>		1/2
Dividend income		6,300	1/2
Trust management expenses: 1,850 x 100/92.5		<u>(2,000)</u>	1
		<u>4,300</u>	
Income Tax at Basic Rate: 500* x 20%		100	1/2
Income Tax at 45%: (21,000 – 500) x 45%		9,225	1/2
Income Tax at 38.1%: 4,300 x 38.1%		1,638	1/2
Income tax at 7.5%: 2,000 x 7.5%		<u>150</u>	1/2
Tax payable on income		<u>11,113</u>	
Tax pool brought forward		500	
Tax pool credit (11,113 – 150)		10,963	1
Tax credit on income distribution: £18,000 x 45/55		<u>(14,727)</u>	1/2
Tax pool deficit		<u>(3,264)</u>	
Total tax payable: £11,113 + £3,264		<u>14,377</u>	1/2

\*Basic rate band divided by two as settlor has created two settlements 1/2

NB professional fees for investment advice is capital expenditure and therefore non-deductible. 1/2

**Total marks for part 1 (7)**

- 2) Replacement of domestic items relief (1/2) will allow a deduction for the cost of a replacement domestic item (such as household electrical items) (1/2), plus the incidental costs of disposing of the old item (1/2) or acquiring the replacement item (1/2), less any amounts received on disposal of the old item (1/2).

If the new item represents an improvement on the old item (beyond the reasonable modern equivalent), the deduction is restricted to the cost of an item that would be considered substantially the same (1/2).

*Credit will be given for other valid comments.*

**Total marks for part 2 MAX (2)**

- 3) If the trust were settlor interested, the settlor would declare the whole of the trust income on their own tax return (1/2) and pay tax on the trust income at their marginal rate (1/2). The income would retain its identity (eg dividend income) in the hands of the settlor (1/2). This means that he can use his dividend allowance and/or savings allowance, if available (1/2). The settlor would be unable to deduct any trust expenses when calculating the tax payable (1/2).

The settlor would be able to claim a credit for the tax payable by the trustees (1/2), which may create a tax repayment if they have a lower marginal tax rate than the trustees (1/2). If part of the tax credit is repaid, the settlor must return the repayment to the trustees (1/2).

*Credit will be given for other valid comments.*

**Total marks for part 3 MAX (3)**

- 4) On any change of trustees, the trust assets must be transferred from the legal ownership of the former trustees to that of the new trustees (1) (who may include some of the former trustees).

If the change of trustees is made by deed, generally the deed of appointment itself operates to vest the trust property in the new trustees (1). The exceptions include certain interests in land (1/2), registered shares and similar securities (1/2). These excepted categories are transferred from the old to the new trustees by appropriate transfer procedures (1).

*Credit will be given for other valid comments.*

**Total marks for part 4 MAX (3)**

**Total marks for question 4 (15)**