THE ASSOCIATION OF TAXATION TECHNICIANS

ATT PAPER 5 INHERITANCE TAX, TRUSTS & ESTATES

May 2021

TIME ALLOWED

3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

PART I

1. Amber died on 12 June 2019. Her estate was valued at £528,000. Included in her estate were shares in a quoted company, Centrica plc. These were valued at £36,000.

   The executors sold all the Centrica plc shares on 20 May 2020 for £21,250.

   On 9 July 2020 the executors purchased shares in BAE Systems plc for £6,800.

   No other disposals or purchases have been made since Amber's death.

   Explain:

   1) the relief the executors can claim;
   2) the IHT effect of the claim; and
   3) any restrictions on the claim.

   Calculate the allowable relief available to the executors. (4)

2. Tony Church created separate discretionary settlements for each of his three nephews and two nieces.

   One nephew was advanced his trust funds in July 2019 and the trust came to an end.

   In September 2020 Tony's sister had a daughter and Tony created a discretionary settlement for his new niece.

   One of the trusts had the following disposals in the year to 5 April 2021:

<u>Residential property – let out to tenants</u>		£
Sale proceeds		345,000
Purchase price	May 1998	235,000
Cost of an extension	June 1999	79,500
<u>Asco plc shares</u>		
Sale proceeds	1,200 shares sold	2.44 each
Cost of shares in Asco plc		1.56 each

   Calculate the Capital Gains Tax payable by the trustees for 2020/21. (3)

3. Tom died on 20 December 2020. At his death he owned shares in his friends' trading company, WJ Ltd. He bought them on 12 February 2019.

   The company did not hold any assets for investment purposes.

   Under Tom's will the shares pass to his widow Jenny.

   Jenny gifted the shares to another shareholder of WJ Ltd on 30 March 2021.

   Explain:

   1) the requirements for 100% business property relief to be available on the gift of shares in WJ Ltd by Jenny; and

   2) if Jenny will qualify for 100% business property relief on the gift of these shares:
   (a) given she was married to Tom at the date of his death; and
   (b) assuming they had never married.

   (4)

4. James Gee created a discretionary trust on 15 December 2002 for the benefit of his newborn nephew.

   James' only other gross chargeable transfer was £77,000 in June 1998.

   The value of the trust at the last 10-year anniversary in 2012 was £724,000.

   On 16 December 2020 the trustees agreed to give the nephew £150,000 for his 18th birthday. The nephew must pay the Inheritance Tax on the distribution.

   Calculate the Inheritance Tax payable by the nephew on the distribution. (3)

5. Brenda died on 13 May 2019. Her executors have provided the following information:

	£	
ISA Interest	125	Received in 2020/21
Rental Income	7,500	Received in 2020/21
Bank Interest	120	Received 6 May 2020
Bank Interest	106	Received 6 August 2020
Bank Interest	110	Received 6 November 2020
Bank Interest	119	Received 6 February 2021
Bank Interest	115	Received 6 May 2021
Dividends	6,500	Received in 2020/21
Interest on Loan to a friend of Brenda's	300	Received 31 March 2021
Interest on IHT Loan	345	Paid 19 August 2020
Interest on IHT Loan	125	Paid 31 December 2020

   The loan to pay the Inheritance tax was taken out on 20 August 2019.

   Calculate the Income Tax payable by the trustees for 2020/21, showing all of your workings and explanations for any items not included. (4)

6. The trustees of the White Rose Discretionary Trust have discovered a minor arithmetic error on the capital gains computation included on the 2019/20 tax return. As a result, a small amount of additional tax will be payable for 2019/20.

   The 2019/20 tax return was issued on 6 April 2020. The trustees submitted the tax return online to HMRC on 20 January 2021. The trustees paid the Capital Gains Tax they calculated at the time, on 21 January 2021.

   Explain:

   1) the timescale for the trustees to correct the 2019/20 tax return;
   2) whether penalties may be incurred for the error in the 2019/20 tax return; and
   3) the interest charges that will apply on the underpaid Capital Gains Tax.

   (3)

7. The trustees of the Wright Family Trust sold a residential property in December 2020. The property was purchased in early January 2002 and was initially rented out to a third party until 31 March 2005. On 1 April 2005, Jessica Wright, the life tenant of the trust moved into the property until she moved out permanently on 31 January 2018. The property remained empty until its sale on 31 December 2020. The trustees made a chargeable gain of £74,000, before deducting any reliefs and exemptions, on the sale of the property.

   Explain the conditions for the trustees to make a valid PPR claim and calculate the relief available to the trustees. (3)

8. An Interest in Possession trust has the following income sources in the year to 5 April 2021.

   1) Rental income, net of allowable expenses;
   2) Dividends; and
   3) Bank interest received gross.

   The trust income totals £40,000 and the life tenants only other source of income is an annual employment salary of £100,000.

   Explain:

   1) the rates of Income Tax a life tenant will pay on each income source;
   2) the effect if the trustees mandate the income to the life tenant; and
   3) the effect of receiving the income on any allowances the life tenant can use against their total income. (4)

9. The executors of Simon Cambridge have completed the administration of his estate. They are now wanting to pay the residuary income to his long term partner, John, after allowing for previous distributions to him and the specific legacies to Simon's friends.

   The executors have undistributed income from a rental property, bank interest and dividends from quoted companies. They have also incurred estate expenses.

   Explain how the residuary income payable to John will be calculated. Your answer should include how the estate expenses will be dealt with. (3)

10. Brian Harding died in March 2021. On his death he owned shares in the following companies:

   1) 100% shareholding in his own trading company, Harding Ltd valued at £330,000.
   2) 5% shareholding in BH plc, valued at £87,500.

   The total Inheritance Tax due on Brian's estate is £260,000 of which £60,000 is due on the shareholding in Harding Ltd and £35,000 on the shareholding in BH plc.

   1) Explain whether Inheritance Tax on each of the shareholdings qualifies for instalment payments.

   2) Calculate the amount of each instalment and state when the first instalment is payable. (4)

11. Andrew and Brian own Yellow Ball Ltd. Andrew owns 60% and Brian owns 40%.

Their old school friend Cyril helped them build their business from scratch, with free mentoring advice. In March 2021 the company transferred £750,000 cash into a trust for the benefit of Cyril's children, to help with their tuition fees.

Andrew created another trust in September 2018 for £185,000 and he makes annual gifts in June each year to use his annual exemption.

Calculate the Inheritance Tax payable by Andrew and his total gross chargeable transfer on the creation of the trust for Cyril's children. (3)

12. Mr Peters has just gifted his main home to his son, but has continued to live in it. Mr Toad has been told that this creates an issue for Inheritance Tax purposes that means the house remains in his estate for Inheritance Tax purposes. Mr Peters wants to find a way of removing the house from his estate whilst still gifting it to his son.

Explain how Mr Peters could avoid treating the house as part of his estate, whilst still living in it for many years to come. (2)

PART II

13. Simon died on 13 July 2020 having made no lifetime transfers. His estate consisted of the following assets:

	£
Main residence	100,000
Country flat (used by Simon at weekends)	130,000
Portfolio of shares in non-trading companies	290,000
Chattels, cash and personal belongings	390,000

The personal belongings include military medals valued at £15,000 which Simon had inherited from his late father David. David had been awarded the medals for gallantry in the armed services.

Simon was also the life tenant of The Saddler Trust which was created in 2010 by his uncle on his 60^{th} birthday. The trust held assets worth £250,000 at the time of Simon's death. The remainderman of The Saddler Trust is Simon's daughter, Stephanie.

Simon's wife died in 2012 leaving her estate worth £2.6 million to Stephanie.

Simon's will directs that £75,000 should be left to a charity and a free of tax legacy of £400,000 should be left to his nephew. The residue of his estate should be left to Stephanie.

Requirements:

1) Calculate, with explanations, the baseline amount, and explain whether the 36% Inheritance Tax rate will apply to Simon's estate. (3)

2) Calculate, with explanations, the Inheritance Tax payable, and the amount that Stephanie receives as a result of her father's death. (4)

3) Calculate the Inheritance Tax payable if the residue of the estate had instead been left to a second charity, and calculate the amount that the second charity receives as a result of Simon's death. (3)

4) Explain the Capital Gains Tax consequences of Simon's life interest in The Saddler Trust coming to an end. (2)

5) Explain what is meant by an absolute reversionary interest in a trust, including the situation where the person holding the interest dies whilst the trust still exists. (3)

Total (15)

14. The Piglet Discretionary Trust was created by Christopher on 29 November 2010. The initial property settled on the trust was £500,000 cash. On 12 April 2015 Christopher added an investment property valued at £260,000 to the trust.

Christopher's other lifetime transfers were as follows:

1) £100,000 to his friend Kanga on 2 May 2007;
2) £50,000 to The Rabbit Life Interest Trust on 9 August 2009; and
3) £80,000 to The Eeyore Discretionary Trust on 29 November 2010.

On 29 November 2020 the investment property was valued at £450,000 and the cash held on capital account was £340,000.

The trustees distributed all income until 5 April 2016. From 6 April 2016 the trustees have made distributions of £40,000 per annum split equally between income and capital. The trust held unaccumulated and undistributed income of £50,000 at 29 November 2020.

The trustees paid any Inheritance Tax arising as a result of all gifts to trust.

In the 2020/21 tax year the trustees of The Piglet Discretionary Trust received the following income:

	£
Bank interest	19,500
Rental income	34,500

Expenses paid during the year were £2,500 for a boiler repair in the rental property, and £5,000 for trust management.

The tax pool brought forward at 6 April 2020 was £1,500.

Requirements:

1) **Calculate, showing all your workings, the Inheritance Tax payable on The Piglet Discretionary Trust's 10-year anniversary on 29 November 2020.** (7)

2) **Explain how unaccumulated and undistributed income which arose more than five years before a trust's 10-year anniversary is treated.** (3)

3) **Calculate the Income Tax liability of The Piglet Trust for the year ended 5 April 2021, and the balance on the tax pool at 5 April 2021.** (5)

4) **State two circumstances in which Inheritance Tax exit charges do not apply to distributions from a discretionary trust created during the donor's lifetime.** (2)

5) **Explain what is meant by a breach of trust and the remedies available to the beneficiaries.** (3)

Total (20)

15. In 2013 Charlotte created The Fairy Trust for the benefit of her two grandsons Tristan and Fergal. In 2014 she created The Pixie Discretionary Trust which is still in existence.

<u>The Fairy Trust</u>

In 2016 the trustees of The Fairy Trust appointed irrevocable life interests to Tristan and Fergal.

On 2 December 2020 the trustees disposed of 500 shares in Widget Manufacture Ltd for £250,000. Widget Manufacture Ltd is an unlisted trading company and neither Tristan nor Fergal has ever worked for the company.

The trustees are considering the distribution of their remaining holding in Widget Manufacture Ltd to Tristan and Fergal in 2021/22. The trustees subscribed for their shares in Widget Manufacture Ltd as follows:

Date	No. of shares	Purchase cost £
6 April 2017	600	60,000
21 May 2017	400	50,000

HMRC have issued an informal written request for information in respect of the trustees' 2019/20 tax return.

Requirements:

1) Calculate, with explanations, the Capital Gains Tax liability of The Fairy Trust for 2020/21. Assume that any relevant relief is claimed. (5)

2) Explain how a claim for holdover relief on the distribution of shares to Tristan and Fergal would affect a future disposal of the shares by them. (2)

3) Explain what actions a member of the ATT should take on receipt of an informal request for information from HMRC in relation to a client. (3)

Total (10)

16. You have received the following email from your tax partner:

To: Tax Assistant
From: Tax Partner
Date: 1 May 2021

Subject: Isaac Brown (deceased)

Our client Isaac Brown died recently and yesterday I met with his widow Mrs Brown to discuss his estate. You may remember that Mrs Brown is also a client of ours.

Mrs Brown informed me that Mr Brown died without having made a valid will and having made no lifetime transfers. His only family are Mrs Brown and their three children who are aged 15, 20 and 22. His estate consists of the following assets:

	£
Personal chattels	100,000
Investments and cash	430,000
Total	530,000

Please could you calculate the Inheritance Tax liability on his estate.

Mrs Brown does not need the income or assets of the estate and so we discussed the possibility of a deed of variation to redirect all assets in the estate to their children. I informed her of the Inheritance Tax consequences of this, and I would be grateful if you could prepare a calculation of the Inheritance Tax payable on the estate on this basis.

I also said I would get back to Mrs Brown with a summary of the Income Tax and Capital Gains Tax effects of a deed of variation and a list of requirements for it to be valid.

Mrs Brown told me that this has focussed her mind on her own tax affairs and she will now write her own will. She asked me if she could appoint her children as executors as they have already indicated they would be willing to act. I advised her that if this firm is asked to assist with the administration of her estate, this could create a conflict of interest, as two of her children are already clients of ours. However, all three of her children have indicated they would still be happy for us to act for the family in both capacities.

Requirements:

Prepare a reply to your tax partner's email in which you:

1) **Calculate, showing how Mr Brown's estate is allocated, the Inheritance Tax payable as a result of his death, assuming no deed of variation is made.** (4)

2) **Calculate the revised Inheritance Tax liability if a deed of variation is made directing all assets to Mr Brown's children.** (1)

3) **Explain the steps Mrs Brown should take to ensure the deed of variation is valid for Inheritance Tax. Briefly explain the Capital Gains Tax effects, and the date from which any Income Tax consequences take effect.** (5)

4) **Explain who Mrs Brown is able to choose as her executor(s) and whether there are any restrictions.** (2)

5) **Explain what actions a member of the ATT should take if they decide to act for two parties where a conflict of interest exists.** (3)

Total (15)