



## **November 2018 Examination**

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### **PAPER 5**

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

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Part I Suggested Answers

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1.

	£	
Gift to registered charity		
- Exempt under s23 IHTA 1984	Exempt	1/2
Gift to grandson		
- Exempt under small gifts exemption	Exempt	1/2
Gift to daughter on marriage	12,000	
Marriage exemption	(5,000)	1
Annual exemption 2017/18	(3,000)	1/2
Annual exemption 2016/17 (3,000 – 2,000)	(1,000)	1/2
Potentially Exempt Transfer	<u>3,000</u>	

**Total****(3)**

2.

	£	
Lily's total gross income	97,500	
Income in higher rate bracket so savings allowance restricted to £500		1/2
Tax at 40%: (£37,500 - £500) x 40%	14,800	1
Less trust tax credit	(7,500)	1/2
Tax Payable for 2017/18	<u>7,300</u>	

The due date for payment of tax is 31 January 2019 (1).

Trust management expenses are not deductible by the trustees of a life interest trust when calculating their tax liability for the year (1/2). They do, however, reduce the net income distributed to the beneficiary, and so the beneficiary does not suffer additional tax on the trust income used to pay the expenses (1/2).

**Total****(4)**

3. Trust assets which are subject to a qualifying interest in possession are treated as forming part of the estate of the beneficiary with the interest in possession (1). The fund is not relevant property (1/2), so is not subject to exit charges (1/2) or principal charges (1/2).

Examples of a qualifying interest in possession trust include: *[any two of the following]*

- A life interest trust created before 22 March 2006 (1)
- An immediate post death interest (IPDI) trust (1)
- A transitional serial interest (TSI) trust (1)

Credit given for any other valid comments

**Total****Max(4)**

4.

	Non-Savings	Dividend	
	£	£	
Rental profits	10,000		
Dividends		22,000	
Tax at standard rate:			
£1,000 x 20%	200		1/2
Tax at trust rates:			
(£10,000 – £1,000) x 45%	4,050		1/2

£22,000 x 38.1%	<u>8,382</u>		½
	12,632		
Add s.496 tax pool deficit*	<u>1,732</u>		½
Total tax payable by trustees	<u>14,364</u>		
Tax pool:			
Brought forward at 6 April 2017	2,000		
Add tax paid by trustees	12,632		½
Less tax credit on distribution: 20,000 x 45/55	<u>(16,364)</u>		1
* s.496 tax pool deficit	<u>(1,732)</u>		
NB no deduction for expenses as capital in nature			
			½

**Total**

**(4)**

5.

	Residential property	Commercial property	
	£	£	
Disposal proceeds (deemed to be MV)	225,000	400,000	½
Less: base cost	<u>(140,000)</u>	<u>(305,000)</u>	½
Capital gain	85,000	95,000	
Annual exemption	<u>(11,300)</u>	-	1
Taxable gain	73,700	95,000	
CGT at 28% / 20%	<u>20,636</u>	<u>19,000</u>	1
Total CGT payable		<u>39,636</u>	

Where a settlor makes a sale at undervalue to a trust and the actual consideration exceeds the CGT allowable costs, then the excess will be a capital gain even when a gift relief claim is made.

(1)

**Total**

**(4)**

6.

	£	£	
CLT made on 12 October 2008 – no further tax as more than seven years have passed			1
CLT made on 24 January 2013:			
Gross CLT		525,000	
NRB at date of death	325,000		½
Less: CLTs made in previous seven years	<u>(320,000)</u>		½
		<u>(5,000)</u>	
Chargeable transfer		<u>520,000</u>	
IHT @ 40%		208,000	½
Taper relief @ 40% (between 4 and 5 years)		<u>(83,200)</u>	1
		124,800	
Less: Lifetime IHT paid		<u>(104,000)</u>	½
Additional IHT payable as a result of death		<u>20,800</u>	

**Total**

**(4)**

7.

	£	
Sale of painting:		
Sale proceeds	85,000	
Cost of disposal	(1,200)	½
Net sale proceeds	83,800	
Base cost	(56,000)	½
Capital Gain	27,800	
Annual exemption	(11,300)	½
Taxable Gain	16,500	
CGT at 10%	1,650	½

**Total**

**(2)**

8. Executors must complete a Self-Assessment tax return if one of the following applies:

- The total income tax and capital gains tax liability for the administration period is £10,000 or more (1)
- The administration period exceeds two years from the date of death (1)
- The probate value of the estate is £2.5 million or more (1)
- The proceeds of assets sold in any one tax year is £500,000 or more (1)
- HMRC considers that the estate is 'complex' (1)

**Total**

**Max(4)**

9. 1)

The replacement land may immediately qualify for Agricultural Property Relief provided that the combined occupation/ownership period is at least two out of the previous five years (1). If the land is tenanted, the combined ownership period is extended to seven out of the previous ten years (1).

2)

The cost of a new drainage system and the erection of new fences would be treated as capital expenditure and so would be deductible in calculating the chargeable gain (1). The fertilizing cost and the wall repair would be classed as revenue expenditure and would therefore not be deductible in calculating the gain (1).

**Total**

**(4)**

10. The instalments are payable in 10 equal amounts (1/2), paid annually (1/2). The first instalment is payable on the usual payment date, i.e. six months after the end of the month of death (1/2).

If the qualifying property is sold by the new owner whilst tax remains outstanding the unpaid balance of tax becomes payable in full at the point of sale (1/2).

**Total**

**(2)**

11.

	£	
IHT value will be lower of:		
Quarter up value:		
$(140p - 132p)/4 + 132p = 134p$		1
Average of marked bargains:		
$(130p + 140p)/2 = 135p$		1

Value will therefore be 134p per share:		1/2
5,000 x 134p = £6,700		1/2

**Total**

**(3)**

12. Upon releasing his reservation of benefit the main home will no longer form part of Mr Toad's death estate (1/2). He is treated as making a PET at the point the benefit is released (1/2). The value of the PET is the market value of the house at the time the reservation ceases (1/2). No annual exemptions are available to reduce the value of the deemed PET (1/2).

*Credit will be awarded for other valid comments.*

**Total**

**(2)**



## **November 2018 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) The payments made by Andy into Michael's pension qualified as "normal expenditure out of income" since they were regular, out of surplus income and did not affect his standard of living (1), so were immediately exempt from Inheritance Tax (1/2) and therefore are not included in the calculation of tax due on Andy's death (1/2).

*Credit will be given for other valid comments.*

Total marks for part 1

(2)

2)

<b>Lifetime Gifts</b>			
<b>Gift - May 2009</b>	Cash into DPI	£335,000	
Gift was a PET (not CLT) so can be ignored when calculating IHT on PET in 2015, as occurred more than 7 years prior to death.			1
<b>PET February 2015</b>	Gift to Michael	175,000	
Less AE 2014/15	Used	-	
Less A/E 2013/14		(3,000)	½
		172,000	
Less Nil Rate Band	325,000		
(Restricted)	(172,000)	(172,000)	½
IHT due – lifetime and on death		nil	

<b>Free Estate</b>			
Property in London	870,000		) ½
Property in France	175,000		)
Cash	55,000		) ½
UK shares	275,000		)
	1,375,000		
Settled Estate – QIIP as trust created pre 22/3/2006			
½ of £750,000	375,000		1
	1,750,000		
NRB (325,000 – 172,000 used)	(153,000)		½
	1,597,000		
IHT @ 40%	£638,800		½
Payable by the personal representatives	1,375,000/1,750,000 x 638,800 =	£501,914	1

Total marks for part 2

(6)

- 3) If Andy had been non-UK domiciled his estate would be subject to UK Inheritance Tax on his UK situated assets only (1/2), rather than his worldwide assets (1/2). Assets situated outside of the UK are "excluded" assets (1/2) for Inheritance Tax purposes. The overall effect would be to decrease his UK Inheritance Tax liability (1/2) by £70,000 (175,000 x 40%). (1/2)

Total marks for part 3

MAX (2)

4)

		Savings	Non-savings	Dividends	
		£	£	£	
Treasury Stock		2,070			
Rental income			6,020		
Dividends				4,000	
		2,070	6,020	4,000	½
General Trust management expenses are not allowable					½
Tax	@ 20%	414	1,204		½
	@ 7.5%			300	½
Total Income Tax due	£1,918				

Total marks for part 4

(2)

- 5) As Andy died without a will, his estate will be distributed in accordance with the Intestacy rules (1/2) so the distribution of his estate will depend on which of his relatives were living at his death (1/2). As he died unmarried and without issue, his closest relative is his brother (1/2) and David will therefore inherit the whole of Andy's estate (1/2). The remaining relatives will not inherit anything (1/2).

Credit will be given for any other valid comments.

Total marks for part 5

MAX (2)

- 6) Under English Law, section 32 Trustee Act 1925 permits the trustees to advance capital to Rebecca as she is the remainderman (1) so she has a presumptive capital interest in the trust (1), unless the trust deed specially prevents this legislation applying to the Trust (1). As David has a prior life interest and assuming he is sui juris, then he must also consent to the advance in writing (1).

The trustees may also be given an express power of advancement under the terms of the trust deed to apply capital for the benefit of Rebecca at their discretion. (1).

Scots Law:

Under Scots Law a power of advancement must be included expressly in the trust deed for it to apply (1). The trustees may therefore only advance capital to Rebecca if an express power is given in the trust deed (1).

If the trust deed makes no reference to the trustees' power of advancement, the court has limited power under the Trusts (Scotland) Act 1921 to permit an advancement (1).

Credit will be given for other valid comments.

Total marks for part 6

MAX (3)



- 7) As your firm already acts for the niece, who is a beneficiary of the trust, and the trustees have also asked you to act for the trust, there may be a conflict of interest. (1)  
If your firm wishes to act for both parties then the following action could be taken:
- Advise both parties of the conflict and give them the opportunity to consider whether to seek alternative representation (1)
  - If both parties agree you can continue to act, provided adequate disclosure is given to both parties and no preference is given to a particular party (1)
  - Appoint a separate team/partner to act for each client and ensure “ethical walls” are maintained to prevent a breach of confidentiality (1)
  - If you do act for both parties it must be done with the full agreement and knowledge of both parties (1)

*Credit will be given for other valid comments.*

**Total marks for part 7**

**MAX (3)**

**Total marks for question 1**

**(20)**

2.

- 1) The Inheritance Tax payable for each gift is calculated as set out below.

<b>10 June 2007</b>			
		£	
Cash		350,000	
Nil Rate Band (2007/08)		(300,000)	½
		50,000	
IHT @ 20/80 (as paid by Donny)		<u>£12,500</u>	1
<b>30 November 2014</b>			
Sunnyside Bakery Ltd shares		420,000	
BPR (100%)		(420,000)	½
Cash		<u>450,000</u>	
		450,000	
Nil Rate Band (2014/15)		(325,000)	½
		£125,000	
IHT @ 20%		<u>£25,000</u>	½

**Total marks for part 1**

**(3)**

2)

<b>10 June 2007</b>	£	£	£	
Cash	£350,000			
Not liable to Capital Gains Tax				½
		<b>Pays CGT</b>	<b>Claim Gift Relief</b>	
<b>30 November 2014</b>				
Cash	£450,000			
Not liable to Capital Gains Tax				

1,200 shares in Sunnyside Bakery Limited		420,000	420,000	
Cost		(36,000)	(36,000)	
Chargeable Gain		<u>£384,000</u>		1/2
			384,000	
Gift relief			(384,000)	1
Chargeable Gain			<u>£ nil</u>	1/2
			420,000	
Gift relief			(384,000)	1/2
Base cost of shares for the trustees		<u>£420,000</u>	<u>£36,000</u>	
		1/2	1/2	

Total marks for part 2 (4)

- 3) The Inheritance Tax payable by the trustees on the 10 year charge is calculated as follows:

Current market values as at 10 June 2017		£	
Shares in Sunnyside Bakery Limited		324,000	
BPR	(100%)	(324,000)	1/2
Cash		450,000	
Minority share holdings in plcs		415,000	
		865,000	
Nil Rate Band (2017/18)	325,000	(325,000)	1/2
		£540,000	
Notional Tax	@ 20%	108,000	1/2
Effective Rate	108,000/865,000 x 100	12.486%	1/2
Notional Rate	12.485% x 30%	3.746%	1/2
Cash :	450,000		
Relief for period before cash added to trust = June 2007 to Nov 2014 = 29 qtrs:			1/2
(40 – 29)/40 = 11/40 ths	x 3.746 x 11/40	4,636	1/2
Shares :	415,000		
	x 3.746%	15,546	1/2
Total Inheritance Tax		£20,182	

Rounding to 3dp. Credit given for other rounding.

Total marks for part 3 (4)

- 4) The Inheritance Tax payable on the distribution to Esme is calculated as follows:

No change in NRB so no need to re-calculate the Actual Rate			
Distribution:			
Cash	£100,000		
Shares	£45,000		
Less BPR (100%)	(£45,000)		1/2

	100,000		
Notional Rate	3.746%		
Complete quarters June 2017 to Jan 2018	2		1/2
Effective rate	$3.746\% \times 2/40 = 0.1873\%$		
Grossed-up rate (as Trustees paying tax)	$0.1873/(100-0.1873) = 0.1877$		
Exit charge	$\pounds 100,000 \times 0.1877\%$	<u>£188</u>	1/2
Tax due date	31 July 2018		1/2

Total marks for part 4 (2)

- 5) Gift Relief will be available (under s.260 TCGA 1992) as the distribution is a chargeable transfer for Inheritance Tax purposes (1).

Gift Relief would also be available as the asset being transferred is a business asset for Capital Gains Tax purposes (under s.165 TCGA 1992) however s.260 TCGA 1992 takes priority (1/2).

Total marks for part 5 MAX (1)

- 6) In order to avoid an Inheritance Tax charge the trustees could give Esme funds from income (1) or advance capital to her within the first quarter following a 10 year charge (1).

Total marks for part 6 MAX (1)

- 7) A trust deed is usually irrevocable and not variable (1), unless the deed includes specific powers permitting the trustees to vary the terms of the settlement (1) otherwise a trust deed may only be varied by an application to the court (1).

Total marks for part 7 (3)

- 8) If Esme refuses to sign the Letter of Engagement despite receiving it, it is still possible to act for her based on her conduct (1), For example, if she sends in her personal information for the completion of her tax return (1).

*Credit will be given for other valid comments.*

Total marks for part 8 (2)

Total marks for question 2 (20)

3.

[Advisor's address]

[Client address]

[Date]

Format mark (1)

Dear Geoffrey

Thank you for the queries regarding your late wife's estate and matters concerning your own financial affairs.

- 1) In order to benefit from the Residence Nil Rate Band (RNRB) you will need to ensure the following:
- Property is inherited by a direct descendant (1/2) (eg your son) (1/2)
  - The relief is only available for one property (1/2) and it must have been used as your residence at some point during your ownership (1/2). If the rental property has not been your residence at any point during your ownership, then only the family home could qualify for the RNRB. (1/2) If you have occupied both properties, then your executors can nominate which property can benefit from the RNRB (1/2).
  - If a property is left on trust, the RNRB will only be available where a direct descendant has an interest in possession in the property (1/2) from the date of your death (1/2).
  - If your estate value is in excess of £2m on death (1/2) the RNRB will be tapered (1/2).
  - The relief is only available on death transfers (1/2) and is available for transfers under a Will (1/2) or on Intestacy (1/2).

As you inherited your wife's estate which was valued at under £2m (1/2), her RNRB will be unused. (1/2) Your estate will benefit from the transfer of her unused percentage which will be 100% (1/2), in addition to your own RNRB.

*Credit will be given for other valid comments.*

Total marks for part 1 (including presentation mark)

(Max 5)

- 2) If you wish to make a charitable legacy in your will and you leave 10% or more of your net estate to charities then your estate would benefit from the reduced Inheritance Tax rate of 36%, instead of the full rate of 40%.

The calculation to check if you meet the criteria can be summarised as follows:

- The 10% of your net estate is calculated by reference to the "baseline amount" (1).
- The "baseline amount" is calculated as the value of your estate which is chargeable to Inheritance Tax after allowing for all available reliefs, exemptions and Nil Rate Band (1) but excluding the RNRB (1/2) and the relief for the charitable gift itself (1/2).
- Calculate 10% of the "baseline amount" and compare this value to the charitable legacy. If the legacy is greater than the 10% value, then the 36% Inheritance Tax rate will apply (1)

In order to ensure your estate will qualify for the lower rate it is possible to include a formula clause in your Will (1). This could state the amount to be gifted to charity must be the greater of an amount equal to 10% of the baseline amount (1) rather than just stating a specific amount.

*Credit will be given for other valid comments.*

Total marks for part 2

(Max 5)

3) The income tax liability is calculated as follows:

	Non-savings	Interest	Dividends	
	£	£	£	
Bank interest		3,450		
Rents	12,500			
Less: Expenses	(1,370)			(1/2)
	11,130			
Pension	5,300			
Dividends 17,200 x £0.50			8,600	(1/2)
	16,430	3,450	8,600	
Taxed at	20%	20%	7.5%	(1)
Tax	3,286	690	645	
Tax liability			4,621	
Less: PAYE			(1,060)	(1/2)
Tax payable			£3,561	

The 2018 estate tax return is due for submission electronically on or before 31 January 2019 (1/2).

Total marks for part 3

(3)

4) I appreciate that you are currently unsure whether to make a Will for your own estate.

There are many advantages of making a Will such as (any 4 of the following):

- Prevents you dying Intestate so your estate is distributed between your family in the proportions as you would wish. (1)
- You can also include gifts to charity and friends (1)
- You can nominate your own personal representatives and trustees (1)
- Your executors can start to act before probate is granted (1)
- You can provide extended powers to your executors and trustees (1)

Once a Will has been made, you can use a Codicil to amend specific aspects without the need to totally re-write your Will. It is a formal document read together with your Will (1)

*Credit will be given for other valid comments.*

Total marks for part 4

(Max 5)

5) Whilst we do act for your children, we owe a duty of confidentiality to all our clients, which includes you (1/2). This duty covers all information entrusted to us, or brought to our attention during our appointment (1/2) The duty lasts indefinitely (1/2). Therefore we would

not disclose any details of your Will to your children, unless you had consented (1/2) for us to do so.

*Credit will be given for other valid comments.*

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

I hope this information is helpful, however if you have any further queries please do not hesitate to contact me.

Yours sincerely

**Total marks for question 3 (20)**