



May 2021 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part I Suggested Answers

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

1.

Post Mortem relief (1/2) will be available to the executors as they sold quoted shares within 12 months of the date of death (1/2) and those sales gave rise to an overall loss (1/2).

Post Mortem relief reduces the IHT value of the estate on death by the amount of the loss (1/2) and may result in a repayment of IHT already paid (1/2).

The allowable loss is restricted if the executors purchase quoted shares (1/2) within the period starting with the date of death and ending 2 months after the last sale occurring within 12 months from the date of death (1/2)

			£
Sale proceeds from Centrica shares	20 May 2020		21,250
Less: Probate valuation	12 June 2019		<u>(36,000)</u>
Loss on sale			(14,750) (1/2)
Restriction:			
Loss	x	<u>Amount invested</u>	
		Total gross sale proceeds	
(14,750)	x	Purchase of BAE System shares 6,800	4,720 (1/2)
		Sale proceeds from Centrica 21,250	
Allowable loss under s.179			<u>£(10,030)</u>
Total			Max (4)

2.

		£	£	£
Residential Property			345,000	
Less: Purchase cost		235,000		
Less: Extension cost		<u>79,500</u>		
Gain			<u>(314,500)</u>	(1/2)
			30,500	
Asco share proceeds	1,200 x £2.44		2,928	(1/2)
Purchase cost	1,200 x £1.56		<u>(1,872)</u>	
Gain			1,056	
Annual exempt amount - restricted	£6,150 / 5 settlements			(1/2)
	Allocated to Property		<u>(1,230)</u>	(1/2)
Taxable gains			<u>29,270</u>	
Capital Gains Tax	@ 28%		<u>8,195</u>	(1/2)
	@ 20%		<u>211</u>	(1/2)
Total CGT payable			<u>8,406</u>	
Total				(3)

3.

In order for Business Property Relief to be available on WJ Ltd shares:

WJ Ltd must be an unquoted (1/2) wholly or mainly (1/2) trading company (1/2) and there must not be a binding contract for the sale of the shares in place at the date of the transfer (1/2).

Normally the shares must also have been owned for at least two years before a transfer for Business Property Relief to be available (1/2).

If they were married, Business Property Relief would be available (1/2) on Jenny's subsequent gift as:

- she inherited the shares from Tom on his death (1/2)
- so their **combined ownership** period was more than two years (1/2).

If Jenny was not married to Tom, Business Property relief would not be available (1/2) on the gift. This is because:

- Tom had not owned the shares for two years prior to his death (1/2)
- So they did not already qualify for relief when Jenny inherited them and she did not own them for two years in her own name prior to the gift (1/2)

Total Max (4)

4.

		£	£
Trust value	16 December 2012		724,000
Nil Rate Band	2020/21	325,000	
Less: CLT in previous 7 years		(77,000)	(1/2)
			<u>(248,000)</u>
			<u>£476,000</u>
Notional tax	@ 20%		<u>95,200</u> (1/2)
Effective rate	<u>95,200</u>	x 100	13.149% (1/2)
	724,000		
Actual rate	13.149% x 30%	x 32/40 quarters	3.156% (1/2)
		3.156% x £150,000	<u>£4,734</u> (1/2)

Quarters : (15.12.2012 – 16.12.2020) = 32 (1/2)

Rounding to 3 dp – credit will be given for other rounding used

Total (3)

5.

Brenda's Estate		Non-Savings £	Savings £	Dividends £
Rental profits		7,500		
Bank Interest	May 2020	120		
	Aug 2020	106		
	Nov 2020	110		
	Feb 2021	<u>119</u>		
	May 2021		455	(1/2)
	NA-21/22 tax year			(1/2)
Interest on a loan to a friend			300	
Dividends				6,500
ISA Interest	Not taxable			(1/2)
Less: IHT Loan Interest				
Within 12 months of advance		(345)		(1/2)
After 12 months of advance	Not allowable			(1/2)
Taxable		<u>£7,155</u>	<u>£755</u>	<u>£6,500</u>
Tax at		20%	20%	7.5%
		<u>£1,431</u>		(1/2)
			<u>£151</u>	(1/2)
				<u>£488</u> (1/2)
Total Income Tax Liability		<u>£2,070</u>		

Total (4)

6.

The trustees can make an amendment to the 2019/20 tax return for the capital gains error up to one year from the due date for filing the tax return (1/2). In this case it will be until 31 January 2022 (1/2).

The trustees took reasonable care when completing the 2019/20 tax return and the arithmetic error was minor (1/2), so HMRC would not issue a penalty to the trustees (1/2).

Interest will accrue daily from 1 February 2021 (1/2) on the underpaid Capital Gains Tax until it is paid to HMRC (1/2).

Total (3)

7.

The trustees can claim PPR where:

Jessica permitted to occupy the property under the terms of the trust (1/2) and Jessica had occupied the property as her main or only residence (1/2)

PPR Relief:

	Dates	Actual Occupation	Deemed Occupation	Non Occupation	
Rented to third party	Early January 2002 – 31 March 2005			39	1/2 (for each row)
Occupied as main residence	1 April 2005 – 31 January 2018	154			
Property Vacant	1 February 2018 – 31 December 2020		9	26	
		154	9	65	
Total Occupation				228	

Therefore relief available = $\frac{\text{deemed} + \text{actual occupation}}{\text{Total occupation}} \times \text{gain}$

$$= \frac{163}{228} \times 74,000$$

$$= \text{£}52,904 \text{ (1)}$$

Total

Max (3)

8.

The life tenant will pay higher rate income tax on the income sources as follows:

Rental income and Bank interest received gross = 40% (1/2)

Dividends = 32.5% (1/2)

If the income is mandated to the life tenant, the trustees will not be liable to income tax on the income, (1/2) otherwise the trustees pay basic rate tax and the life tenant gets a tax credit for the tax paid. (1/2)

The effect on the allowances the life tenant is entitled to is:

- the standard personal allowance will be reduced to nil as their income is over £125,000. (1),
- the dividend allowance of £2,000 remains unchanged (1/2) and
- the personal savings allowance remains at £500 (1/2).

Total

(4)

9.

John is deemed to have received the total residuary income (1/2), less any income actually, or deemed, to have been distributed (1/2), less estate expenses chargeable against the residual income (1/2).

Estate expenses are deemed to have been paid from dividend income first (1/2). If the estate expenses are greater than the residuary dividend income, the balance of the expenses is deemed to have been paid from interest (1/2). Finally, any remaining estate expenses are deemed to have been paid from non-savings income such as the rental income (1/2).

Total

(3)

10.

The Inheritance Tax on the shares in Harding Ltd qualifies for the instalment payment option as:

- The shares are unquoted (1/2) AND
- The transferor had “control” of the company immediately before the transfer, ie had the power to exercise more than 50% of the voting rights (1/2) AND
- The shareholding is greater than 10% shareholding in the company (1/2) AND
- The value transferred by the shares is at least £20,000 (1/2)
- The Inheritance Tax on the shares is at least 20% of the total Inheritance Tax payable by the executors (1/2).

The Inheritance Tax on the shares in BH plc does not qualify for the instalment payment option as the transferor did not have “control” of the company immediately before the transfer, ie had the power to exercise more than 50% of the voting rights (1/2)

Inheritance tax instalments are calculated as 1/10th of the total payable ie £6,000 (1/2) and the first instalment is payable by 30 September 2021 (1/2), ie six months after the end of the month of death.

Total (4)

11.

As the close company has made a transfer of value, the transfer is apportioned to Andrew and Brian, as the participators of the company (1/2).

Tax payable by Andrew		Share is 60%
		£
Transfer value	£750,000 x 60%	450,000 (1/2)
Less annual exemptions	2020/21	(Nil) (1/2)
	2019/20	(Nil)
		450,000
Nil rate band 2020/21	(325,000)	
Less: CLT in previous 7 years	<u>(185,000)</u>	
		<u>(140,000) (1/2)</u>
Taxable		<u>£310,000</u>
Inheritance Tax payable @ 20/80		£77,500 (1)
Gross chargeable transfers	450,000 + 77,500	£527,500 (1/2)

Total (3)

12.

It is possible to avoid a Gift with Reservation of benefit (1/2) charge if the Mr Peters pays his son (1/2) full consideration for the benefit retained (1/2) for example, a full commercial rent that would be charged to an unconnected third party (1/2).

The rent should be reviewed regularly to reflect market changes (1/2)

Marks will be awarded for any other valid comments

Total

Max (2)



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Inheritance Tax, Trusts & Estates

Part II Suggested Answers

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

13. 1)

	£	
Death estate:		
Main residence	100,000	
Country flat	130,000	
Investment portfolio	290,000	
Chattels, cash and personal belongings**	<u>375,000</u>	½
Total *	<u>895,000</u>	
Baseline amount:		
Gross chargeable estate	895,000	
Less NRB***	<u>(325,000)</u>	½
Baseline amount	<u>570,000</u>	
So the 36% rate will apply as at least £57,000 (Baseline x 10%) is left to charity.		½
Notes:		
*The Saddler Trust is not included in the estate as it is not a QIIP		½
**Military medals are excluded from IHT providing they have never been purchased		½
***The Residence Nil Rate Band is not deducted when calculating the baseline amount		½
Total marks for part 1		(3)

2)

	£	
Tax on death estate:		
Gross chargeable estate	895,000	
Gift to charity	(75,000)	½
Residence nil rate band*	(130,000)	½
Nil rate band	<u>(325,000)</u>	½
	<u>365,000</u>	
IHT payable at 36%	<u>131,400</u>	½
Value received by Stephanie:		
Total estate of Simon on death (£895,000+£15,000)	910,000	½
Less gift to charity and tax-free legacy (£75,000 + £400,000)	(475,000)	½
Less tax paid	(131,400)	½
Value of The Saddler Trust	<u>250,000</u>	½
Value received by Stephanie	<u>553,600</u>	
*RNRB – restricted to £130,000 being value of the country flat (as the more valuable of his two residences)		
Total marks for part 2		(4)

3)

	£	
Tax on death estate:		
Tax-free legacy	400,000	½

Residence nil rate band*	(0)	½
Nil rate band	<u>(325,000)</u>	½
	<u>£75,000</u>	
IHT payable x 36/64	<u>£42,188</u>	½

*There is no longer a direct-lineal descendent inheriting the relevant residential property and so the RNRB no longer applies.

Value received by the second charity:

	£	
Total estate of Simon on death (£895,000+£15,000)	910,000	½
Less pecuniary gift to first charity and tax-free legacy (£75,000 + £400,000)	(475,000)	½
Less tax paid	<u>(42,188)</u>	½
Value received by second charity	<u>£392,812</u>	

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

- 4) For CGT purposes, the transfer of the trust assets to Stephanie is a disposal by the trustees (1/2). The trustees are deemed to receive market value for the assets (1/2) and a chargeable gain or allowable loss will arise on the transfer of any chargeable assets (1/2). The trustees will be able to claim holdover relief on any gain as an exit charge for IHT purposes will arise provided Simon's death is not within three months of the trust's 10 year anniversary (1/2).

Total marks for part 4 **(2)**

- 5) An absolute reversionary interest means the interest is vested so the remainderman will take the property at the end of the interest in possession (1). However, if they die before then, their interest will pass into their estate and be inherited by the persons identified in their Will or under the law of intestacy (1). The legatees would then acquire the trust property at the end of the interest in possession in lieu of the remainderman (1).

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

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

14. 1) IHT payable on Piglet Discretionary Trust 10-year anniversary:

	£	£	
Value of trust property on 29 November 2020*		790,000	
Initial value of relevant property in Eeyore Trust Being a related settlement		<u>80,000</u>	½
		870,000	
Nil rate band 2020/21	325,000		½
Less: Settlor's cumulative total**:			

Gift to The Rabbit Life Interest Trust	£50,000		
Annual exemption 2009/10 & 2008/09	<u>£(6,000)</u>		
	(44,000)		1
Distributions in past 10 years (£20,000 x 5)	<u>(100,000)</u>		1
		<u>(181,000)</u>	
		689,000	
Notional tax			
689,000 x 20%		137,800	½
Effective rate			
137,800/870,000 x 100%		15.839%	½
Actual rate			
15.839% x 30%		4.752%	½
IHT arising:			
Investment property:			
£450,000 x 4.752% x (40-17 ^{***})/40		12,296	½
Cash: £340,000 x 4.752%		<u>16,157</u>	½
Total IHT payable		<u>28,453</u>	
*Does not include undistributed and unaccumulated income as < 5 years			½
**Does not include gift to Kanga as would have been a PET			½
***Complete quarters between trust creation and addition –			½
29 November 2010 – 12 April 2015 = 17			
NB tax rate to 3 decimal places			
Total marks for part 1			(7)

- 2) Undistributed income which arose more than five years before a trust's 10-year anniversary and has not been formally accumulated is treated as part of the trust's capital value (1/2) and is subject to the 10-year charge (1/2).

There is no proportionate reduction for the quarters before the income arose (1/2); it is subject to the full 10-year charge rate (1/2).

The income remains income for all other purposes (1/2) and can be paid out to any beneficiary entitled to income (1/2).

Total marks for part 2 (3)

- 3) Income Tax payable by trust for 2020/21:

	Non-savings £	Savings £	
Net rental income (34,500 – 2,500)	<u>32,000</u>		½
Bank interest		19,500	
Trust management expenses: 5,000 x 100/80		<u>(6,250)</u>	1
		<u>13,250</u>	
Total income (32,000 + 13,250)		<u>45,250</u>	

Income Tax at Basic Rate: $333^* \times 20\%$	66	$\frac{1}{2}$
Income Tax at 45%: $(45,250 - 333) \times 45\%$	20,213	$\frac{1}{2}$
Income tax at 20%: $6,250 \times 20\%$	<u>1,250</u>	$\frac{1}{2}$
Tax payable on income	<u>21,529</u>	

Tax pool brought forward	1,500	
Tax pool credit (21,529 – 1,250)	20,279	$\frac{1}{2}$
Tax credit on income distribution: £20,000 x 45/55	<u>(16,364)</u>	1
Tax pool as at 5 April 2021	<u>5,415</u>	

*Basic rate band divided by three as settlor has created three settlements $\frac{1}{2}$

Total marks for part 3 (5)

4) An exit charge does not arise when:

- Trustees distribute trust income that has not been accumulated (1)
- Trustees distribute capital within 3 months of the trust being set up (1) or within 3 months of a 10-year anniversary (1)
- Trustees distribute excluded property (1)

Any two of the above.

Total marks for part 4 MAX of (2)

5) A breach of trust arises where trustees fail to carry out their duties in accordance with the terms of the trust instrument or the law or because they exercise their powers improperly (1).

Where a trust suffers a loss as a result of a breach of trust, the beneficiaries have two distinct remedies available to them:

- They can recover trust property that still exists and is identifiable in the hands of the trustees or other persons who have received it (1)
- Alternatively, or in addition, they can claim damages from the trustees, who are in the first instance personally liable for any loss (or the balance of any loss) not recovered through an action to recover trust property (1)

Total marks for part 5 (3)

Total marks for question 2 (20)

15. 1)

	Investor Gains £	
Disposal of shares:		
Sale proceeds	250,000	
Cost (s104 pool):		
500/1000 x (50,000+60,000)	<u>(55,000)</u>	1
Gain	195,000	
Annual exempt amount*	<u>(3,075)</u>	½
Taxable Gains	<u>191,925</u>	
CGT at 10%**	<u>19,193</u>	½

* Divided by two as settlor has one other trust in existence ½

** Investors relief can be claimed by the trustees as they subscribed for the shares which have been owned for over 3 years; 2 x ½

And there is an eligible beneficiary who has held an IIP for at least three years and is not an employee of the company. 3 x ½

(5)

- 2) If a claim for holdover relief was made, the chargeable gain would effectively be deferred by reducing the base cost of the asset in the hands of the Tristan and Fergal (½). This is likely to lead to a larger gain being triggered on a future disposal of the shares (½).

Tristan and Fergal would not be able to claim investors' relief or Business Asset Disposal Relief on their future disposal of the shares, as they are not the original subscribers of the shares (for IR) or employees of the company (for BADR) (1). The gains are likely to be taxed at 20% (assuming there is no remaining basic rate band available for either of them). (½)

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

- 3) A member should check the engagement letter to see whether there is permission to disclose such information to HMRC (1). If there is not (or there is any doubt) they should request the clients' permission to disclose the information. (1)

A member should advise the client that there is no obligation to comply with an informal request in whole or in part (1).

They should also advise the client whether it is in the client's best interests to disclose such information, as lack of cooperation may have a direct impact on penalty negotiations post-enquiry (1).

Total marks for part 3

MAX (3)

Total marks for question 3

(10)

16.

To: Tax Partner
From: Tax Assistant
Date: 4 May 2021
Subject: Isaac Brown (deceased)

Format mark (1)

Further to your email of 1 May 2021, please find set out below the information that you requested.

1) **Calculation of IHT based on intestacy rules**

	£	£	
To Mrs Brown under Intestacy Laws:			
Personal chattels	100,000		½
Investments and cash:			
£270,000* + (430,000 – 270,000)/2	<u>350,000</u>		1
	450,000		
Spouse Exemption	<u>(450,000)</u>		½
Remainder of estate:			
530,000 – 450,000		80,000	½
Nil rate band (restricted)		<u>(80,000)</u>	½
Taxable estate		<u>Nil</u>	
IHT payable		<u>Nil</u>	

*Note credit will be given if candidates use £250,000 here as per most recent law manual.

Total marks for part 1 (including format mark)

(4)

[Scottish Alternative to part 1:

	£ Mrs Brown	£ Children	
Intestacy rules:			
Prior rights to spouse	50,000		½
Legal rights:			
To wife: 1/3 x (530,000 – 50,000)	<u>160,000</u>		½
Total to Spouse	210,000		
Spouse exemption	<u>(210,000)</u>		½
		-	
To children: 1/3 x (530,000 – 50,000)		160,000	½
The dead's part (to children):			
1/3 x (530,000 – 50,000)		<u>160,000</u>	½

Total to children	320,000	
Nil rate band (restricted)	<u>(320,000)</u>	½
	<u>Nil</u>	
Total marks for part 1 (including format mark)		(4)]

2) **Calculation of IHT with Deed of Variation**

	£	£	
Total estate		530,000	
Nil rate band		<u>(325,000)</u>	½
Taxable estate		<u>205,000</u>	
Inheritance tax @ 40%		<u>£82,000</u>	½
Total marks for part 2			(1)

3) **Requirements for a valid Deed of Variation for IHT purposes**

In order for the deed of variation to be valid, Mrs Brown should ensure it is:

- in writing (1/2)
- signed by Mrs Brown (1/2) within two years from the date of Mr Brown's death (1/2) and with the consent of the Mr Brown's administrators, since it would result in more IHT becoming payable (1/2)

A statement under s142 IHTA 1984 should be included to ensure the deed is effective for Inheritance Tax (1/2).

For Capital Gains Tax purposes, the redirection of the assets through a deed of variation will be treated as a disposal by the original beneficiary at market value at the date of the deed (1). The original beneficiary may however include an election under s62 TCGA 1992 which would disregard the gift for CGT purposes (1/2), instead the new beneficiary would be deemed to have received the asset directly under the terms of the will and at probate value (1/2).

For Income Tax purposes, a deed of variation is always effective from the day it is made; and cannot apply retrospectively (1).

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

4) **Executors of the estate**

Mrs Brown is able to choose whoever she likes to be her executor(s) (1/2), providing they have mental capacity to act (1/2).

She can appoint a minor to act, but they cannot obtain probate until they reach the age of 18 (1)

Total marks for part 4 (2)

[Scottish Alternative to part 4:

Mrs Brown is able to choose whoever she likes to be her executor(s) (1/2), providing they have mental capacity to act (1/2).

She can appoint a minor to act, but they cannot obtain probate until they reach the age of 16 (1).

Total marks for part 4 (2)

5) **Conflicts of Interest**

How the conflict is handled should be noted on file (for example using separate teams to act for each party) (1) and where possible, confirmed in writing to the client (1). The arrangements should then be regularly reviewed by the member (1).

Total marks for part 5 (3)

Please let me know if you need any further information

Kind regards

Tax Assistant

Total marks for question 4 (15)