Practical Tax People

Association of Taxation Technicians

May 2017 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

TIME ALLOWED – 3 ¼ HOURS
(for Part I and Part II)

- You are required to answer **all** questions in each part (both parts printed together).
- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation and annotate your question paper. Calculators may not be used during this time.
- The Presiding Officer will inform you when you can start writing in the answer booklets.
- You are provided with two answer booklets (one for each part of the paper). Make sure you write your answers in the correct answer booklet.
- Please start each answer on a fresh page and do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question requires otherwise.

Part I

Write your answers in the Part I answer booklet.

1. On 25 September 2014 Morris created an Interest in Possession trust with £465,000 cash and paid the Inheritance Tax due on the transfer. In the previous tax year, he had gifted £3,000 to his brother.

   Morris died on 9 December 2016.

   Calculate the Inheritance Tax payable on the creation of the trust and on Morris's death. (4)

2. It is possible for an individual with a UK domicile of origin to acquire a domicile of choice in a different country.

   Explain what a domicile of choice is and how having a non-UK domicile affects an individual's UK Inheritance Tax position. (2)

3. The recipient of a lifetime gift can become liable to pay Inheritance Tax on that gift on the subsequent death of the donor.

   Explain the Inheritance Tax consequences for a donee on both the receipt of a lifetime gift from another individual and on the subsequent death of that individual. (4)

4. William created a Discretionary Trust for his nephew and niece on 3 May 2016. He sold his portfolio of unquoted trading company shares to the trust for £300,000. The unquoted shares had a market valued of £450,000. William had acquired the shares in October 1997 for £163,500.

   This was William's only disposal in 2016/17. He is a higher rate taxpayer.

   1) **Calculate William's Capital Gains Tax liability assuming a hold over claim is made and calculate the resulting base cost of the shares for the trustees.**

   2) **Explain who is required to sign the holdover election in order for a valid claim to be made.** (4)

5. Frances created the Griffin Discretionary Trust on 4 August 2006 and settled £75,000 cash. She had not made any previous chargeable lifetime transfers.

   On 2 May 2009 she also settled unquoted shares which were valued at £125,000.

   As at 4 August 2016 the shares were valued at £685,000 and the cash balance remained at £75,000.

   Calculate the Inheritance Tax 10 year charge arising on 4 August 2016. (4)

6. Louise is the beneficiary of an Interest in Possession trust created for her benefit in 2001 by her mother. On the same day her mother set up an identical trust for her brother.

   The trust owns shares in the family company, Ginger Cake Ltd. Louise has worked for the company for nearly three years and throughout this time has owned 30% of the company's ordinary shares and voting rights.

   The trustees of Louise's trust decided to sell their 3% holding in Ginger Cake Ltd on 27 August 2016. The gross sale proceeds totalled £120,000 and there were selling costs of £125. The trustees had acquired the shares in 2001 for a market value of £40,000, which was agreed with the District Valuer at the time.

   The trust made no other gains during the year to 5 April 2017.

   Calculate the Capital Gains Tax payable by the trustees for 2016/17, explaining any reliefs available to them. (4)

7. On 4 January 2013 James gifted £300,000 cash to his daughter to help her buy her first home. This was his only lifetime transfer.

   James died unexpectedly on 26 April 2016, leaving a gross estate valued at £1.2 million. His will left a cash legacy of £100,000 to his favourite charity, with the residue of his estate passing to his daughter.

   Calculate the Inheritance Tax payable as a result of James's death, clearly explaining whether the estate qualifies for the 36% rate of tax. (4)

8. The Gregory Trust is an Interest in Possession Trust created in March 2016 for the benefit of the settlors' daughter, Ava, who is in her 20s.

   The trustees hold large sums of cash on deposit. The interest received for 2016/17 totalled £9,380. No taxable income arose in 2015/16.

   Calculate the Income Tax payment that the trustees will be required to make on 31 January 2018. (2)

9. Steve died on 13 December 2001 leaving an estate valued at £465,000. His will left his estate to his wife Sarah with the exception of his rare model car collection, valued at £105,000, which passed to their son Paul.

   Sarah died on 6 June 2016 leaving her entire estate, valued at £530,000, to Paul.

   Calculate the Inheritance Tax payable on Sarah's death. (4)

10. Peter died in June 2013 having been resident and domiciled in the UK all his life. The executors of his estate have made the following disposals of estate assets:

	Date of sale	Proceeds	Probate value
		£	£
Spanish apartment	September 2015	249,500	245,000
Investment portfolio	May 2016	162,275	134,000

Calculate the Capital Gains Tax payable by the executors for each relevant tax year. (2)

11. Trusts for bereaved minors have special Inheritance Tax treatment if they meet certain conditions.

Describe the conditions for a bereaved minors trust to be entitled to special Inheritance Tax treatment. (2)

12. David died in May 2013 leaving his house in France to his friend Tom. The house was valued at £500,000 and the UK Inheritance Tax paid on the property was £70,000.

Tom died in September 2016 still owning the French house, which was then worth £550,000, along with other assets worth £304,000. Tom had not made any other lifetime transfers.

Both Tom and David were UK domiciled.

Calculate the Inheritance Tax payable on Tom's death. (4)

Part II

Write your answers in the Part II answer booklet.

Marks are specifically allocated for appropriate presentation.

1. Bernie Smith created the Smith Discretionary Trust on 29 November 1991 and, in accordance with the trust deed, the trust ended on the 28 November 2016 when the trustees distributed the assets between the discretionary beneficiaries.

   The initial trust property was £1 million cash and this was Bernie's only lifetime transfer. The trustees invested the trust fund as follows:

	Purchase date	Purchase cost	Value 28 November 2016
		£	£
5% holding in Widget Trading plc	1 January 1993	85,000	153,000
Unit 6, Enterprise Park	14 March 2011	322,000	375,000
Seaview Cottage	29 September 2012	250,000	295,000

   Under the terms of the trust, a beneficiary was allowed to occupy Seaview Cottage as their main residence from 29 January 2014 until the trust ended. Unit 6, Enterprise Park was a commercial property let to a third party.

   The trust's only other asset on 28 November 2016 was cash of £600,000, which included unaccumulated and undistributed income of £95,000 that had arisen since the trust's previous 10 year anniversary.

   The effective rate of tax at the trust's previous 10 year anniversary was 14.15%.

   You are required to:

   1) **Calculate, showing all your workings, the Inheritance Tax payable on the winding up of the Smith Discretionary Trust on 28 November 2016.** (3)

   2) **State the form on which the Inheritance Tax must be reported and the due date for payment of the liability.** (1)

   3) **Calculate, showing all your workings, the Capital Gains Tax payable as a result of the distribution of the trust assets to the beneficiaries. (Ignore holdover relief for this part of the question.)** (5)

   4) **Explain whether holdover relief would be available on the distributions and, assuming it is available, explain what the effects of making a claim for holdover relief would be for the beneficiaries.** (3)

   5) **State three matters which should be addressed by a member of the Association of Taxation Technicians in a letter of disengagement.** (3)

Total (15)

2. James Burnley, an existing client, is meeting with you next week to discuss the discretionary trust he created in 2010. Currently the trust holds a residential property with a mortgage, shares in investment companies, and cash deposits.

The trust's first 10 year anniversary is in three years' time, and James is keen to understand how the Inheritance Tax payable as a result of this event will be calculated. He would also like to know if he could reinvest trust funds in any way to reduce the expected Inheritance Tax charge.

During a recent telephone call, James also mentioned he may recommend to his co-trustees changing the terms of the trust in order to give his struggling brother a life interest and would like to discuss this at the meeting.

You are required to:

1) List five items of information that will be required in order to calculate the Inheritance Tax 10 year charge for the trust. (5)

2) Explain what types of assets the trustees could purchase in order to obtain Business Property Relief, and how these investments could affect the 10 year charge calculation. (3)

3) 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)

4) Briefly explain whether there are any Income Tax, Capital Gains Tax and Inheritance Tax consequences of converting the discretionary trust to an Interest in Possession trust. (3)

5) Explain when trustees are legally able to vary the terms of a trust. (2)

Total (15)

3. You have received the following letter from Mr Patel, a client you have recently taken on:

Dear Adviser

As you know, my father died on 5 April 2017 and I am a co-executor of his estate. I have a number of queries in respect of the estate which I am hoping you may be able to assist with.

Having dealt with the Inheritance Tax aspects, we are now gathering the information in order to complete the first estate tax return. I would be grateful if you could give me some guidance on how the income arising in the administration period will be taxed.

Other than triggering a capital loss on the disposal of my father's quoted share portfolio, the estate seems fairly simple, and we do not expect the tax liability for the administration period to exceed a couple of thousand pounds. I have heard that there are special provisions for simple estates such as this; please could you give me some more details?

In light of recent events I have recently drafted my own will; is there anything in particular I need to do in order to formalise my draft document?

Finally, I have also been meaning to ask whether you will be reminding me of any due dates for payments of tax now that I have transferred the tax affairs of my family's trust to you?

I look forward to hearing from you.

Yours sincerely

Mr Patel

You are required to write a letter to Mr Patel in which you should:

1) **Explain how the estate's Income Tax liability will be calculated.** (3)

2) **Explain whether there is any relief available for the loss made on the sale of the quoted shares.** (3)

3) **State the conditions for an estate to qualify to make an informal payment of the total tax liability for the whole administration period together with a single Income Tax and Capital Gains Tax computation.** (3)

4) **State the requirements for making a valid will.** (3)

5) **Explain the duties of a member of the Association of Taxation Technicians in relation to due dates and interest for a tax compliance client.** (3)

Total (15)

4. The Potter Discretionary Trust had the following income, expenses and distribution during the year ended 5 April 2017:

	£
Dividend income	6,300
Rental income from a furnished residential property	24,000
Letting agent fees	3,000
Professional fees for trust investment advice	500
Trust management expenses	1,850
Income distribution to beneficiary	18,000

The tax pool brought forward at 6 April 2016 was £500, and the settlor had created one other discretionary trust during her lifetime.

On 6 April 2017 new trustees were appointed. The new trustees would like to replace some of the electrical appliances in the kitchen of the rental property with new ones of a similar standard, as they have not been replaced for a number of years.

You are required to:

1) Calculate the Income Tax payable by The Potter Discretionary Trust for the year ended 5 April 2017. (7)

2) Explain what tax relief will be available for the replacement of white goods when the trustees calculate their 2017/18 Income Tax liability. (2)

3) Explain the effect on the settlor's Income Tax position if the trust were settlor interested. (3)

4) Explain what action(s) should be taken in respect of a trust's assets when new trustees are appointed. (3)

Total (15)