November 2017 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part I Suggested Answers

1.

The lex situs of an asset is its location for Inheritance Tax purposes (1/2). For chattels, the lex situs is the country in which the chattel is physically located (1/2), so the lex situs of Pierre's paintings will be France (1/2).

If Pierre is non-UK domiciled (1/2) he will only be subject to Inheritance Tax on his assets situated in the UK (1/2). Any assets situated outside the UK, such as his paintings, would be excluded property (1/2) and therefore would not be subject to Inheritance Tax in Pierre's estate (1/2).

If Pierre is UK domiciled (1/2) then his paintings will be liable to UK IHT (1/2) even though their lex situs is France.

Credit will be given for other valid comments.

Total (max 4)

2.

Age 18 to 25 trusts are not relevant property so are not subject to inheritance tax 10 year charges (1).

While the beneficiary of the trust is under 18 years of age, the trust is not subject to exit charges (1/2). If, however, any of the following events take place after the beneficiary turns 18 then an exit charge will arise:

- A capital distribution is made (1/2)
- The beneficiary becomes absolutely entitled to the trust property (1/2); or
- The beneficiary dies. (1/2)

Total (3)

3.

In order for Mrs Hardy's gifts to be treated as normal expenditure out of income, they must be habitual or regular (eg annual) in nature (1), and must leave her with sufficient income in order to maintain her usual standard of living (1). Gifts which qualify as normal expenditure out of income are immediately exempt from Inheritance Tax (1).

Total (3)

4.

	£	
Initial value	800,000	
Initial value of added property	200,000	½
Nil rate band – 2016/17	(325,000)	½
	675,000	
Notional tax 675,000 x 20%	135,000	½
Effective rate 135,000/1,000,000 x 100%	13.5%	½

Actual rate 13.5 x 30%	4.05%	½
IHT payable:		
£100,000 x 4.05% x *(35-32)/40	304	½
* Quarters: 2 January 2008 to 18 October 2016	35 quarters	½
* Quarters: 2 January 2008 to 31 March 2016	32 quarters	½

Total (4)

5.

	£	
Disposal proceeds	100,000	
Less: disposal costs	(1,300)	½
	98,700	
Base cost:		
£150,000 - £30,000	(120,000)	1
Inheritance Tax paid	(2,000)	½
Capital loss	23,300	

The trustees must first set losses against capital gains arising in the same tax year (1/2). Any excess losses must then be carried forward to use against future capital gains (1/2).

Total (3)

6.

Using loss to donor and related property rules:

	£	
Total value of related property before transfer: Five vases = £800,000		½
Jessica's share: £800,000 x (300,000/(300,000 + 125,000))	564,706	1
Total value of related property after transfer: Four vases = £500,000		½
Jessica's share: £500,000 x (125,000/(125,000 + 125,000))	(250,000)	1
Transfer of value	314,706	

Total (3)

7.

	£	£	
Value of trust fund:	700,000		
Undistributed income over 5 years old: 5 x £20,000	100,000		1
		800,000	
Nil rate band 2016/17		(325,000)	½
		475,000	
Notional tax at 20%		95,000	½
Effective rate (95,000/800,000 * 100%)		11.875%	½
Actual rate:			
11.875% x 30%		3.563%	½
Inheritance Tax payable:			
£800,000 x 3.563%*		28,500	1
* No adjustment for quarters for undistributed income			
NB Rates of tax to 3dp. Credit given for other rounding.			

Total (4)

8.

Foreign property, the value of which is quoted in a foreign currency, must be converted into sterling for the purpose of valuing the death estate (1/2). The London Buying rate should be used for the conversion (1/2) using the exchange rate at the date of death (1/2).

The open market value (1/2) of Mark's half share in the holiday home should be determined. As the house is held jointly with his sister, the related property rules do not apply (1/2). Instead, a discount usually in the region of 5% to 15% (1/2) would be applied to 50% of the value of the entire property (1/2).

Credit will be given for other valid comments.

Total MAX (3)

9.

	£	
Rental income 3,500 x 11	38,500	½
Less repairs	(1,900)	½
Net rental income	36,600	
Income Tax at Basic Rate: 1,000* x 20%	200	½
Income Tax at 45%: (36,600 – 1,000) x 45%	16,020	½
Income tax payable by trustees	16,220	

If Harold had been able to benefit from the trust from the time it was created, it would have been a settlor interested trust for Inheritance Tax purposes (1/2). The transfer to the trust would still have been a chargeable lifetime transfer and subject to Inheritance Tax calculated using the usual method (1/2). However, the trust would also fall within the gift with reservation of benefit rules (1/2), and the trust fund would be deemed to continue to form part of Harold's estate (1/2) so would be liable to Inheritance tax on his death (1/2), even though the trust would still be liable to relevant property trust charges (1/2).

Credit will be awarded for other valid comments.

Total MAX (4)

10.

	£	£	
Main home		450,000	
Shares in Doorknobs Trading Ltd	250,000		
BPR at 100%	(250,000)		½
		nil	
Factory used by Doorknobs Trading Ltd	200,000		
BPR at 50%	(100,000)		½
		100,000	
Chattels, cash etc		100,000	
Chargeable estate		650,000	
Nil rate band 2016/17		(325,000)	½
Taxable estate		325,000	
IHT at 40%		130,000	½

Total (2)

11.

	Occupation by beneficiary (Years)	Absence (Years)	
1 October 2001 – 30 September 2002		1	½
1 October 2002 – 31 March 2008	5 ½		½
1 April 2008 – 31 March 2010		2	½
1 April 2010 – 1 October 2016	6 ½		½
Total	12	3	
	£		
Sale proceeds	950,000		
Base cost	(300,000)		½
Gain	650,000		
Less: PPR Relief: 650,000 x 12/15	(520,000)		1
Chargeable gain	130,000		
Capital Gains Tax at 28%	36,400		½

Total (4)

12.

	£	
2015/16:		
Painting:		
Sale Proceeds	49,000	
Probate value	(72,000)	
Capital loss	(23,000)	½
Shares in Invest plc – not a chargeable disposal	nil	½
2016/17:		
Investment property:		
Sale Proceeds	229,000	
Less: Probate value	(181,000)	
Costs of establishing title to the property	(1,200)	½
Capital gain	46,800	
Capital loss brought forward	(23,000)	½
Less: Annual exemption	(11,100)	½
Taxable gain	12,700	
Capital gains tax payable at 28%	3,556	½

Total (3)

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Inheritance Tax, Trusts & Estates

Part II Suggested Answers

1.

1)

Rosie's Capital Gains Tax	£		
Rental property at market value	975,000		
Less: Cost in July 1989	(395,000)		½
Less: Enhancement in November 1994	(204,000)		½
	376,000		
Holdover: restricted (975,000 – 750,000)	(225,000)		1
Chargeable gain (750,000 – 395,000 – 204,000)	151,000		
Less: Annual exemption 2016/17	(11,100)		½
Capital Gain	£139,900		
CGT at 28%	£39,172		½
Total marks for part 1			(3)
2)			
Trustee's Inheritance Tax liability	£		
Rental property at market value	975,000		½
Less: Sale proceeds	(750,000)		½
Transfer of value = CLT	225,000		
Annual exemption – 2016/17	(3,000)		½
Annual exemption – 2015/16	(3,000)		
	219,000		
Nil rate band: 2016/17			
(325,000 – 155,000)	(170,000)		1
	£49,000		
IHT at 20%	£9,800		½
Total marks for part 2			(3)

3) Inheritance Tax: The creation of an interest in possession trust during lifetime will be a chargeable lifetime transfer for the settlor (1/2). The trust will fall under the relevant property regime (1/2) and will be subject to exit charges and principal charges (1/2).

If the trust is created on death, any Inheritance Tax due on creation will be paid by the estate (1/2). This will be a qualifying interest in possession trust (1/2) and will form part of the beneficiary's estate for Inheritance Tax (1/2). There would be no exit charges or principal charges (1/2).

(max 3)

Income Tax: There are no differences as the Income Tax position is the same for an interest in possession trust whether it is created during the settlors' lifetime or on death (1/2).

Capital Gains Tax: An interest in possession trust created during lifetime can benefit from s165 and s260 Holdover relief, both on creation of the trust and appointment of assets to a beneficiary (1/2) whereas a trust created on death can only benefit from s165 Holdover relief on appointment of assets to a beneficiary (1/2).

Credit will be given for other valid comments.

Total marks for part 3 (max 4)

4) The effect will be to increase the Inheritance Tax payable on an exit or principal charge as the same day additions to both trusts will be taken into account in the calculations (1).

Credit will be given for other valid comments.

Total marks for part 4 (1)

5) A resulting trust occurs when a trust ends and the trust assets revert back to the settlor, or the estate if the settlor is dead (1).

Any two of the following examples:

- All beneficiaries have died and there is no direction given in the trust deed to specify where the trust assets should be applied or appointed (1)
- The trust purpose has been achieved but there are surplus trust funds in the trust (1)
- Property is purchased by a settlor and held in someone else's name with no agreement to who the equitable owner/beneficiaries should be (1).

Credit will be given for other valid examples.

Total marks for part 5 MAX (3)

6) Where a client is reluctant to disclose information (also known as irregularities), to HM Revenue & Customs but has not refused to, the member should encourage the client to disclose (1/2) initially orally (1/2) and then if necessary in writing (1/2). The client should be advised of the potential consequences of a non-disclosure eg interest, penalties and surcharges (1/2) and the benefits of making a voluntary disclosure to HM Revenue and Customs (1/2). The client should also be advised of HM Revenue and Customs powers to obtain information (1/2). The client should be informed that the member is obliged to cease acting if disclosure is not made (1/2).

Credit will be given for other valid comments.

Total marks for part 6 MAX (2)

Total marks for question 1 (16)

2. 1) Income Tax payable by the executors for each period is calculated as set out below.

2016/17	Non-Savings	Savings		
	£	£		
Rental income	7,385			
Bank Interest		3,600		
Interest on IHT loan				
£20,000 x 3.9% x 5/12	(325)			1
	7,060			
Income tax rate	20%	20%		
Income tax due	£1,412	£720		
	½	½		
Net income	*£5,648*	*£2,880*		
2017/18		Savings	Dividends	
		£	£	
Interest		2,400		
Dividends			3,000	
Income tax rate		20%	7.5%	
Income tax due		£480	£225	
		½	½	
Net income		*£1,920*	*£2,775*	

Total marks for part 1 (3)

2)

2016/17				
Total distribution-stamp collection	£8,000			
R185	Net	Tax		
	£	£		
Non-savings	5,648	1,412		½
Savings (balance)	2,352	588		½
	£8,000			

Total marks for part 2 (1)

3)

2017/18				
R185	Net	Tax		
	£	£		
Savings				
(2,880 - 2,352 + 1,920)	2,448			1
(720 – 588 + 480)		612		½
Dividends				
	2,775		}	½
		225	}	

Total marks for part 3 (2)

4) The income tax payments and tax return due in 2018 will be as follows:

2016/17 Income tax liability	Due 31 January 2018	½
2017/18 1st Payment on account	Due 31 January 2018	½
2017/18 2nd Payment on account	Due 31 July 2018	½
2016/17 tax return	Due 31 January 2018	½

Total marks for part 4 (2)

5) An executor is a personal representative appointed by a valid will (1/2). In contrast, an administrator is a personal representative appointed by the court (1/2) where a valid will is not present (1/2), or the executors under the will do not take out a grant of representation (1/2).

Executors take direction from the will (1/2) and the ownership of the deceased's assets vests in them from the date of death (1/2). In contrast, administrators take direction from the courts (1/2) and the property of the deceased only vests with them following the date of the grant of letters of administration (1/2).

Scots Law answer

An executor nominated by the will (1/2) is known as the 'executor-nominate' (1/2). Where there is no 'executor-nominate' (1/2), or on an intestacy (1/2), application must be made to the court (1/2) for an executor to be appointed. Such an executor is known as an 'executor-dative' (1/2).

Both types of executor must first obtain a court order known as a 'confirmation' (1/2), which gives the legal right to deal with the estate (1/2).

Credit will be given for other valid comments.

Total marks for part 5 MAX (3)

6) It is important to document a fee charging structure with a client, usually in a letter of engagement (1/2) to ensure clarity between the member and client for the basis of fees to be charged (1/2) and also how expenses on behalf of the client will be treated (1/2).

Any three of the following fee arrangements:
Time and expenses (1/2)
Fixed fees (1/2)
Contingent/success fees (1/2)
Insurance (1/2)

Total marks for part 6 (3)

Total marks for question 2 (14)

3. 1) The additional Inheritance Tax payable on the CLT into the trust is calculated as follows:

	£		
Gross CLT	848,750		
Add: APR – withdrawn	950,000		½
	1,798,750		
Nil Rate Band (2016/17)	(325,000)		½
Taxable	1,473,750		
IHT at 40%	589,500		½
Taper relief (4-5 years) 40%	(235,800)		1
	353,700		
Less: Lifetime tax paid	(104,750)		½
IHT payable by the trustees	£248,950		

Total marks for part 1 (3)

2) The Inheritance Tax on the estate is calculated as follows:

Assets at death:	£		
Family home in Dorset	450,000		
Cottage in Wiltshire	70,000		
Cash and small chattels	5,000		
	525,000		
Less: Spouse exemption	(450,000)		½
	75,000		
Less: allowable expenses			
Income tax	(6,300)	}	1
Probate costs	-	}	
Funeral	(5,000)	}	
	63,700		
Nil Rate Band already utilised			
IHT at 40%	£25,480		½

The Inheritance Tax will be payable at the earlier of:
6 months from the end of the month of death, therefore 31 August 2017 (1/2) or
Delivery of the IHT return to HM Revenue and Customs (1/2)

Total marks for part 2 (3)

3) The conditions for the full amount of Residence Nil Rate Band to be available on Mary's death are:

- She dies after the commencement date of 6 April 2017 (1/2)
- She owns her home (or a share of it) which she used as her residence at some point during ownership (1/2)
- The house must be inherited by a direct descendant of Mary (1/2) (eg her son Sam)
- Her whole estate value must not exceed £2m (1/2).

Mary will receive an increased RNRB as a result of Matthew's death even though he died before 6 April 2017. (1/2) 100% of his RNRB can be transferred to Mary to use on her death, (1/2) in a similar way to the existing TNRB (1/2),

Credit will be given for other valid comments.

Total marks for part 3 MAX (3)

4) A Deed of Variation can have the effect of re-writing the will for Inheritance Tax and would apply from the date of death (1/2) if a statement under s.142 IHTA 1984 is included (1/2). If the statement is not included, then Mary would be deemed to have made a PET for Inheritance Tax purposes (1/2).

A similar statement is available for Capital Gains Tax under s.62 TCGA 1992 (1/2). Inclusion of this statement has the effect of disregarding the gift at the date of the variation so Mary would not have a capital gain (1/2). The family home would then be inherited by Sam at its probate value at the date of death for Capital Gains Tax purposes (1/2). If the statement is not included, Mary would make a Capital Gains Tax disposal of part of the farmhouse (1/2)

Inclusion of either the Inheritance Tax and/or Capital Gains Tax statements in a Deed of Variation is not mandatory (1/2).

Credit will be given for other valid comments.

Total marks for part 4 MAX (3)

5) Any three of the following types of legacies:
Specific: A specific part of the estate which is identifiable from the rest of the estate eg my rose-gold watch (1)
General: A gift which does not refer to a specific part of the estate eg a watch (1)
Pecuniary: A gift of money eg £1,200 (1)
Demonstrative: A gift of money from a specific part of the deceased's estate eg £1,200 from my Halifax bank account (1)
Residuary: A legacy left to a named beneficiary who receives the remainder of the estate eg what is left after all other legacies, costs and taxes have been paid (1).

Scots law

A general legacy is one where no particular item of property is identified to satisfy the legacy, for example, a legacy of a sum of money. (1)
A special legacy is one where a specific item of property has been identified to satisfy the legacy, such as a legacy of a painting or racehorse. (1)
The residuary legacy consists of the remainder of the estate after all prior legacies have been satisfied in full. (1)

Total marks for part 5 (3)

Total marks for question 3 (15)

4.

1) The Income Tax for the trust is calculated as follows:

	Non-savings	Savings	Dividends		
	£	£	£		
Property income					
(12,480 – 2,850 – 820 – 310)	8,500				1
Bank interest – paid gross		3,000			
Dividends – paid gross			6,300		
Management expenses (333 x 100/92.5)			(360)		1
	8,500	3,000	5,940		
Tax payable:					
Standard rate (restricted to 1/5th of £1,000)					½
200 x 20%	40				½
(8,500 – 200) = 8,300 x 45%	3,735				½
3,000 x 45%		1,350			½
5,940 x 38.1%			2,263		½
360 x 7.5%			27		½
Total Income Tax liability	3,775	1,350	2,290	£7,415	

Total marks for part 1 (5)

2) If Freddie received an income distribution, he would receive £10,000 with a 45% tax credit (1/2) franked by the trust's tax pool (1/2). If the tax pool is insufficient to frank the payment, the trustees will have an additional Income Tax charge (1/2).

The gross income distribution is taxable income of Freddie (1/2) and depending on his personal tax position he may be able to reclaim some or all of the tax credit (1/2) by utilising his personal allowance and basic rate tax bands.

The income distribution is treated as non-savings income, regardless of the original income source within the trust (1/2) and therefore does not qualify for the savings allowance or dividend allowance (1/2).

If Freddie received a capital distribution he would receive £10,000 but with no tax credit (1/2). This would not be taxable income for Freddie (1/2). It would be an Inheritance Tax exit charge for the trust (1/2). Any Inheritance Tax suffered by the trustees is not able to be used as a tax credit for Freddie (1/2).

Credit will be given for other valid comments.

Total marks for part 2 MAX (4)

3) The tax pool is calculated as follows:

	£	
Balance brought forward	1,173	
Add: tax paid by trustees		
Standard rate band	40	½
Non-savings income	3,735	½
Savings income	1,350	
Dividends	2,263	½
	8,561	
Less: Tax on distribution to grandson		
(10,000 x 45/55)	(8,182)	½
Balance carried forward	£379	

Total marks for part 3 (2)

4) The Capital Gains Tax for the trust is calculated as follows:

	£	
Sale proceeds	37,000	
Less: Costs of sale	(500)	
	36,500	½
Purchase cost (10,000 x £2.35)	(23,500)	½
	13,000	
Annual Exemption (restricted to 1/5th of £5,550)	(1,110)	½
Capital Gain	£11,890	
Capital Gains Tax at 20%	£2,378	½

Total marks for part 4 (2)

5) A breach of trust occurs when the trustees fail to carry out their duties (1/2) under the terms of the trust deed or law, or because of their own conduct (1/2).

Remedies (one only):

The beneficiaries may recover trust property (1/2) if it still exists and the trustees still own it. (1/2).

OR

The beneficiaries may claim damages from the trustees (1/2) who are, in the first instance, personally liable for any loss where recovering property in full has not been possible (1/2).

Total marks for part 5 (Max 2)

Total marks for question 4 (15)