May 2018 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part I Suggested Answers

1.

Current values	£	
Investment portfolio	543,278	
Cash	278,583	
Shares in Bubble Trading plc	745,000	
Less: Business Property Relief (50%)	(372,500)	(1)
	1,194,361	
Nil Rate Band	(325,000)	(1/2)
	869,361	
Notional tax at 20%	173,872	(1/2)
173,872/1,194,361 x 100%	14.558%	(1/2)
14.558% x 30%	4.367%	(1/2)
£1,194,361 x 4.367%	£52,158	(1/2)

Calculated to 3 dp. Credit will be given for other rounding.

The Inheritance Tax will be due 6 months from the end of the month of the 10 year anniversary, 31 December 2017 (1/2).

Total (4)

2.

Bracelet:

Normal method of computation: £6,375 - £3,250 = £3,125 (1/2)

Chattels Rule*: (£6,375 - £6,000) x 5/3 = £625 (1)

*The bracelet is tangible moveable property which will last for more than 50 years (ie not a wasting asset) (1/2). As the sale proceeds exceed £6,000 and the original cost was less than £6,000, the 5/3rds chattels rule will apply (1/2).

The lower of the two figures (i.e. £625) is subject to Capital Gains Tax (1/2).

Watch:

The watch is a wasting asset as it has a predictable useful life not exceeding 50 years (1/2). Wasting assets are exempt from Capital Gains Tax (1/2).

Total (4)

3.

The assets gifted to Dave by Rodney have decreased in value between the date of gift and the date of death (1/2). Dave can make a "fall in value" claim under s.131 IHTA 1984 (1/2).

The holiday home: The value used to calculate the death Inheritance Tax on the Potentially Exempt Transfer of the holiday home will be the lower valuation (1/2). The fall in value claim is calculated between the value at the date of gift (1/2), being £405,000 and the value at the date of death, being £295,000 (1/2) so the latter value is used to calculate the IHT due on death (1/2). (However, the original value of the PET is still carried forward for cumulation purposes. (1/2))

Holiday home contents: A fall in value claim cannot be made for the furniture contents (1/2) as these are wasting chattels (1/2). A wasting chattel would not be expected to have a useful life exceeding 50 years and is therefore expected to reduce in value (s.132 IHTA1984) (1/2).

Cash: No claim can be made in respect of the fall in value of the neighbouring property purchased for rental, as the original gift to Dave was cash (1/2).

Total (Max 4)

4.

For Inheritance Tax purposes, the investment portfolio is treated as belonging to Lottie and will be included in her estate on death (1/2). A Bare Trust does not fall within the relevant property regime (1/2) and is not subject to exit charges or principle charges (1/2).

As the fund is taxed as though it belongs to Lottie, the income is taxed in her hands at her marginal rates (1/2). The income tax rates applicable to trusts do not apply to Bare Trusts (1/2).

A Bare Trust is taxed as though the beneficiary owns the trust assets (1/2) so any capital gains from the disposal of any trust asset will be taxable on Lottie (1/2).

Credit will be given for any other valid comments.

Total (Max 3)

5.

	Non-savings	Savings	Dividends		
	£	£	£		
Rental income	13,505				
Bank interest		650			
UK Dividends			3,200		
Tax					
20%	2,701	130			(1/2)
7.5%			240		(1/2)
R185 entries:					
Net Income	10,804	520	2,960		(1/2)
Tax	2701	130	240		(1/2)

The income retains its nature in Lucy's hands (1/2). She will be able to use her personal allowance, savings allowance and dividend allowance against the trust income in calculating her income tax liability (1/2). She will be able to claim an income tax refund by completing a repayment claim form R40 (1/2).

Credit will be given for any other valid comments. (Max 1)

Total (3)

6.

Hannah bought the stock on 30 May 2017 with the right to receive the interest payment on 30 June (1/2). Hannah therefore paid the executors a higher price for the stock to reflect the "accrued income" (1/2).

The executors will need to adjust the sale proceeds to exclude the accrued income element as this will be subject to Income Tax, not Capital Gains Tax (1/2).

Hannah will be able to deduct the accrued income element of the cost incurred on 30 May 2017 from the interest payment received on 30 June 2017 and she will pay Income Tax on the net amount (1/2).

Total (2)

7.

The replacement business asset must qualify for business property relief (BPR), but need not be exactly the same type of asset as that sold (eg an interest in a trading partnership can replace shares in an unlisted trading company) (1).

BPR will be available if the aggregate ownership periods of the original and replacement business asset totals at least two of the five years immediately before the transfer where relief is claimed (1). In other words, the new business asset must be acquired within 3 years of the disposal of the original business asset (1).

BPR on the replacement business property cannot exceed that which would have been available on the original business property owned (1).

The sale proceeds of the original business property must be used to acquire (ie replace) the replacement business property (1).

Marks will be awarded for any other valid comments.

Total (Max 3)

8.

		£	
Rental income		12,500	
Trust expenses	£640 x 100/80	(800)	(1/2)
		£11,700	
Tax			
Standard rate	1,000 / 5 = 200 x 20%	 40	(1/2) (1/2)
RAT	11,700 – 200 = 11,500 x 45%	5,175	(1/2)
Trust expenses	800 x 20%	160	(1/2)
		£5,375	

Tax pool		40	
		5,175	
		£5,215	(1/2)
Maximum net distribution	5,215 x 55/45	£6,374	(1)

Total (4)

9.

A domicile of dependency may be acquired by a child under the age of 16 (1/2); when a parent (usually their father (1/2) although it could follow the mother or legal guardian (1/2)) changes their own domicile (1/2) the child will automatically acquire the same new domicile as that parent (1/2).

Where a non-UK domicile of dependency is acquired, only the child's assets situated within the UK are subject to UK Inheritance Tax (1/2). Assets situated outside of the UK are deemed "excluded assets" (1/2) and are outside the scope of UK Inheritance Tax (1/2).

Credit will be given for other valid comments.

Total (Max 3)

10.

		£	
Initial value of the trust		500,000	
Related trust		500,000	(1/2)
		1,000,000	
Nil rate band at exit		(325,000)	(1/2)
		675,000	
Notional tax	x 20%	135,000	(1/2)
Effective rate	135,000/1,000,000 x 100	13.5%	(1/2)
Actual rate	13.5% x 30% x 27*/40	2.734%	(1/2)
Grossed up	2.734 / (100 – 2.734) x 100	2.811%	(1/2)
Inheritance Tax due	2.811% x £50,000	£1,405	(1/2)

Calculated to 3 dp. Credit will be given for other rounding.

* 16 Sept 2010 to 12 Aug 2017 = 27 quarters (1/2)

Total (4)

11.

Poppy has made a disposal to Iris for Capital Gains Tax purposes (1/2). The disposal proceeds for the capital gain calculation will be the market value at the date of the gift on 16 January 2018 (ie £265,000) (1/2) and the cost will be the probate value on Daisy's death (ie £235,000) (1/2). A gain £30,000 will arise on the gift and the tax will be payable by Poppy (1/2). Iris will acquire the property with a base cost equal to the market value at the date of gift (1/2).

Any income during the period from Daisy's death to the date of the gift to Iris will be attributable to and taxable on Poppy (1/2). Income arising after the date of the deed of variation will be taxable on Iris (1/2).

Credit will be given for other valid comments.

Total (Max 3)

12.

A Pre Owned Asset Tax charge in relation to land arises where:

1) The donor continues to benefit from land they previously owned, (1/2) whether directly or indirectly (1/2).
2) The transfer does not fall within the Gifts With Reservation rules (1/2).

The amount subject to Income Tax is known as the "appropriate rental value" (1/2). This is the annual open market rental amount (1/2) which should be reviewed every 5 years (1/2). Any rent paid under a legal obligation (1/2) for the use of the land will be deductible when calculating the amount liable to income tax (1/2).

Credit will be given for other valid comments.

Total (Max 3)

May 2018 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part II Suggested Answers

1.

1) Available NRB:

	£	
Sinead's NRB 2017/18	325,000	½
Transferable NRB (TNRB) inherited from husband:		
NRB in 2006/07 = £285,000		½
(285,000 – 57,000)/285,000) x 100 = 80%		½
£325,000 x 80%	260,000	½
Sinead's Residence NRB (RNRB): Estate value under £2 million therefore full £100,000 available for 2017/18	100,000	½
Transferable RNRB (TRNRB): Full allowance of £100,000 available from husband as he died prior to 6 April 2017	100,000	½
Total NRB available to Sinead	785,000	
Total marks for part 1		(3)

2) Tax on lifetime transfers

	£	
14.03.2014 – gift to niece		
Value of gift	4,000	
Annual exemption 2013/14	(3,000)	}½
Annual exemption 2012/13	(1,000)	}
PET	nil	
25.12.2015 - gifts to grandchildren		
Each gift under small gifts limits	Exempt	½
26.11.2017 – Investment property to daughter		
Value of gift	375,000	
Annual exemption 2017/18	(3,000)	}½
Annual exemption 2016/17	(3,000)	}
PET	369,000	
IHT on death:		
26.11.2017 – Investment property to daughter		
PET	369,000	
NRB plus TNRB (£325,000 + £260,000 = £585,000 so restricted accordingly)	(369,000)	½
Additional tax on death	nil	
Total marks for part 2		(2)

3) Taxable death estate:

	£	£	
Main home		580,000	} ½
Chattels, cash and personal belongings		20,000	}
Agricultural land	125,000		
APR @ 100% x £100,000	(100,000)		1
		25,000	
Life policy – written into trust for children		nil	½
Shares in Returns plc: Quarter up price: 320p + ((332–320)/4) = 323p			1
Average of bargains: (319 + 328)/2 = 323.5p			1
Take lowest: 5,000 x £3.23		16,150	½
Total assets		641,150	
Less legacy to charity		(30,000)	½
Chargeable estate		**611,150**	
RNRB plus TRNRB: (£100,000 + £100,000)	200,000		½
NRB plus TNRB: (£325,000 + £260,000)	585,000		
Less amount used for lifetime transfers	(369,000)		½
		(416,000)	
Taxable estate		195,150	
IHT @ 36%*		**70,254**	½
*Check to see whether 36% rate applies:			
Baseline amount:			
Taxable estate excluding charitable donation 195,150 + 30,000	225,150		1
10% x baseline amount	22,515		½
Donation of £30,000 is in excess therefore 36% rate applies			
Total marks for part 3			(8)

4) The court can order:

- The transfer of property (1/2)
- Payment of a lump sum (1/2)
- Payment of an invoice (1/2)
- Settlement of property (1/2)

[*Scottish alternative*

The free moveable estate is divided into two equal parts (1/2). Half is subject to the legal rights claim of the children (1/2), and half is allocated to the dead's part (1/2) which is distributed to legatees or (if there are none) to those entitled on intestacy (1/2).]

Total marks for part 4 (2)

Total marks for question 1 (15)

2.

Memorandum

To: Tax Partner
From: Tax Assistant
Date: 2 May 2018
Subject: Estate of John Linley deceased

Format mark (1)

1) **<u>Taxation of interim distributions</u>**

A residuary beneficiary is taxed on income from the estate when they receive it (1/2); they are not treated as receiving income as it arises (1/2).

The income will have already been taxed via the estate tax return at basic rates (1/2), and this reclaimable basic rate tax credit passes to the beneficiary (1/2). If the beneficiary is a higher or additional rate taxpayer they will have further Income Tax to pay on the distribution (1/2).

The income retains its character, (1/2) so it may utilise the beneficiary's Personal Savings Allowance or Dividend Allowance if applicable (1/2). It is deemed to be paid first from non-savings income, interest and then dividends. (1/2)

Total marks for part 1 (including format mark) MAX (3)

2) **<u>Amendment of the estate tax return</u>**

A taxpayer has the right to amend a return already submitted within 12 months of the due date for filing (1/2). The 2016/17 return was due to be filed by 31 January 2018 (1/2), and so the PRs have until 31 January 2019 to write to HMRC to inform them of the error (1/2).

The due date for payment of the 2016/17 estate Capital Gains Tax liability was 31 January 2018 (1/2).

Total marks for part 2 (2)

3) **Requirements for a valid will**

For a will to be valid, the following requirements must be met:

- It must be in writing (1/2)
- It must be signed by the testator (1/2)
- The testator's signature must be witnessed by two persons who are present together when the testator signs the will (1/2)
- The witnesses must then each sign the will in the presence of the testator and of each other (1/2)
- The testator must be sui juris (over 18 and have mental capacity) (1/2)
- The testator must intend the will to be operative as a testamentary disposition (1/2)
- The will should be dated (1/2)

[*Scottish alternative*

For a will to be valid:

- *It must be in writing (1/2)*
- *It must be subscribed by the testator (1/2)*
- *It must be signed at the end (1/2)*
- *However, if it is witnessed by one witness and if it extends over more than one sheet, each sheet is signed by the testator, the will is also presumed to be validly signed (1)*
- *The testator must comprehend the nature of the testamentary act (1/2)*
- *The testator must be at least 12 years old (1/2)*]

Total marks for part 3 MAX (3)

4) **Personal Representative duties**

The Personal Representatives of an estate are required to:

- Determine the assets and liabilities of the estate (1)
- Obtain probate or letters of administration (1)
- Collect the assets of the estate and pay the liabilities of the deceased (1)
- Deal with HMRC and settle any tax liability (1)
- Distribute the estate in accordance with the terms of the will or the intestacy rules (1)

[*Scottish alternative*

The executor-nominate of an estate is required to:

- *Determine the assets and liabilities of the estate (1)*
- *Obtain 'confirmation' which gives the legal right to deal with the estate (1)*
- *Collect in the assets of the estate and pay the liabilities of the deceased (1)*
- *Deal with HMRC and Revenue Scotland and settle any tax liability (1)*
- *Distribute the estate in accordance with the terms of the will or the rules on intestacy (1)*]

Total marks for part 4 MAX (4)

5) **Fee payments on account and in advance**

The terms of such payments should be incorporated into the letter of engagement before the member starts to act for the client (1).

Any such payments should be reasonable in amount in relation to the likely level of fee which will be charged for the work performed (1).

Where professional work paid for in advance by the client is not carried out, such fees paid in advance must be repaid (1).

Substantial payments in advance should be treated with caution (1).

A member should ensure that he has sufficient funds (including interest) available to refund the client where necessary (1).

The member should ensure that there is proper accounting for any VAT that may arise in respect of payments on account or advance payments (1).

Total marks for part 5 MAX (3)

Total marks for question 2 (15)

3. 1) Income Tax payable in respect of Mr Swift's estate:

	NS £	Savings £	Dividend £	
2016/17				
Employment income	96,000			½
ISA interest (taxable after death)		2,500		}½
Bank interest*		50,000		}
Rental income (1,500 x 7)	10,500			½
Dividends (20,000 x £3)			60,000	½
Total	106,500	52,500	60,000	
Tax @ 20%/20%/7.5%	21,300	10,500	4,500	1
Total tax liability	36,300			
Less PAYE	(16,000)			½
Income Tax payable for year	20,300			
2017/18				
Bank interest*		50,000		
Rental income (1,500 x 5)	7,500			½
Dividends (15,000 x 2)			30,000	1
Total	7,500	50,000	30,000	
Tax @ 20%/20%/7.5%	1,500	10,000	2,250	1
Income Tax payable for year	13,750			
* Bank interest taxed on receipt				

Total marks for part 1 (6)

2) Capital Gains Tax payable:

	£	£	
2016/17			
31.01.2017 Shares in Invest Ltd:			
Proceeds	210,000		
Probate value	(240,000)		
Capital loss		(30,000)	½
10.03.2017 Diamond ring			
Proceeds	30,000		
Probate value	(20,000)		
Capital gain		10,000	½
Loss to carry forward to 2017/18		(20,000)	½
2017/18			
12.08.2017 Painting:			
Proceeds	95,000		
Probate value	(75,000)		
Capital gain		20,000	½
05.09.2017 Rose Cottage			
Proceeds	400,000		
Probate value	(346,000)		
Capital gain		54,000	½
11.12.2017 London Flat – transfer to beneficiary is not a chargeable disposal			1
	20% rate	28% rate	
Total gains	20,000	54,000	
Capital losses brought forward		(20,000)	1
Annual exemption 2017/18	.	(11,300)	½
Taxable gains	20,000	22,700	
CGT @ 20%/28%	4,000	6,356	1
Total CGT payable for 2017/18	10,356		

Total marks for part 2 (6)

3) A member owes a duty to respect the confidentiality of information acquired as a result of professional and business relationships. (1)
Information must not be disclosed to third parties without proper and specific authority, (1) unless there is a legal or professional right or duty to disclose. (1)
Information must not be used for the personal advantage of the member or third parties. (1)

Total marks for part 3 MAX (3)

Total marks for question 3 **(15)**

4. 1) Spouse exemption is not available on a lifetime gift to a discretionary trust (1/2) as such trusts do not include a qualifying interest in possession (1/2).

Normal expenditure out of income can apply to lifetime gifts to a discretionary trust (1/2) if there is a series of gifts (1/2) that meet the three conditions for the exemption (1/2).

Credit given for any other valid comments

Total marks for part 1 MAX (2)

2) IHT payable on creation of Puddleduck Trust:

		£	£	
2.04.2013 – creation of trust				
Gift to trust:				
Cash			500,000	
Shares		300,000		
BPR @ 100%		(300,000)		½
			-	
Gift after reliefs			500,000	
Annual exemption 2012/13			(3,000)	} ½
Annual exemption 2011/12 – used (see below)			nil	}
CLT			497,000	
Nil rate band		325,000		
Less gift on 5 April 2012	50,000			
Annual exemption 2011/12	(3,000)			} ½
Annual exemption 2010/11	(3,000)			}
Less cumulative total		(44,000)		½
			(281,000)	½
Chargeable to IHT			216,000	
IHT @ 20/80 x 216,000			54,000	1
Gross CLT: 497,000 + 54,000			551,000	½

Total marks for part 2 (4)

3) Additional IHT payable as a result of Jemima's death on 1 June 2017:

	£	£	
Gross CLT (as above)	551,000		
Add BPR withdrawn due to sale of shares:			
300,000 x 7,000/10,000	210,000		1
		761,000	
Nil rate band	325,000		
Less cumulative total	(44,000)		
		(281,000)	½
Taxable on death		480,000	
IHT @ 40%		192,000	½
Less: Taper relief (4-5 years = 40%)		(76,800)	½
		115,200	
Less: credit for lifetime tax paid		(54,000)	½
Additional tax payable as a result of Jemima's death		61,200	

Total marks for part 3 (3)

4) The primary responsibility for payment of lifetime IHT on a CLT rests with the settlor (1/2), but the trustees may pay some/all of the IHT due (1/2).

The due date for payment of lifetime IHT on a CLT is the later of:

- Six months from the end of the month of the gift (1/2); or
- 30 April in the following tax year (1/2).

Any additional tax on death is payable by the trustees (1/2).

The due date for payment of additional IHT on a CLT as a result of the settlor's death is six months from the end of the month of death (1/2).

Total marks for part 4 (3)

5) The three certainties are:

- Intention – the words must clearly indicate that the settlor is directing that the property be held on trust. (1)
- Subject matter - the property that is the subject of the trust must be certain and the interests of the beneficiaries in that property must be ascertainable (1)
- Objects (beneficiaries) - the settlor must identify or provide the means of identifying the persons whom the trustees are to regard as the beneficiaries of the trust (1)

Total marks for part 5 (3)

Total marks for question 4 (15)