



Practical Tax People
Association of
Taxation Technicians

May 2015 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Candidate Script

Part I

QUESTION NO. 1

CANDIDATE NO.

1) Terry Unused Nil Rate Band

Estate	£400,000	
Less: spousal exemption	(£200,000)	
	<u>£200,000</u>	
Less: NRB 2007/8	£300,000	
Less: transfers in		
7 years prior	(£20,000)	- Annual exemptions used to
NRB remaining	(£280,000)	unavailable to reduce
		P&T.
Unused NRB =	£80,000	= ~ 27%

2) Catherine - IHT due on death

Estate	£800,000	
NRB =		
£325,000 x 127%	(£412,750)	Using proportion of unused
	<u>£387,250</u>	spouse NRB.

QUESTION NO. 2

CANDIDATE NO.

Gains made on gifts are not subject to CGT and there is therefore no liability due from the executor.

2013/14 CGT

Shares in ABC Ltd

Proceeds	£19,000
Less: cost	(£12,000)
Gain	£7,000
Less: Annual exemption	(£11,000)

Chargeable gain —

CGT @ 28% Nil

2014/15 CGT

Shares in DEF plc

Proceeds	£48,000
Less: cost	(£40,000)
Gain	£8,000
Less: Annual exemption	(£11,000)

Chargeable gain —

CGT @ 28% Nil

QUESTION NO. ... 3

CANDIDATE NO. .

10 Year anniversary charge - 27 October 2014

Current value of trust property £925,000

less: NRB 2014/15	(£325,000)
	£600,000

Notional IHT @ 20%	£120,000
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Effective rate

$\frac{£120,000}{£925,000} \times 100\%$	12.9%
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Actual rate

$12.9\% \times 30\%$	3.87%
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IHT due ($3.87\% \times £925,000$)	£35,798
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QUESTION NO. 4

CANDIDATE NO.

Exit charge arising in 2020

Value of property at date of 10 yr anniversary £925,000

Less: NRB 2020/21	(£350,000)
	<u>£575,000</u>

Notional IHT @ 20%	<u>£115,000</u>
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Effective rate

$\frac{£115,000}{£925,000} \times 100\%$	12.4%
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Actual rate

$12.4\% \times 30\% \times \frac{17}{40}$	1.58%
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IHT due (1.58% x £395,000)	<u>£6,241</u>
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QUESTION NO. 5.....

CANDIDATE NO.

Finnick Discretionary Trust 2014/15

Dividends (6000 x 100/90) £6667 @ 37.5% £2,500

Tax pool

B/fwd balance £950

Add: tax on dividends £2,500

Less: dividend tax

credit (£1,833)

Less: Beneficiary tax

credit

(1650 x 45/55) (£1,350)

Tax pool balance £683

QUESTION NO. 6.....

CANDIDATE NO.

Trustees must inform HMRC of disposal of capital assets on the trust tax return. This is due on the usual self-assessment deadline of 31 January ~~the~~ following the tax year to which the return relates, or 31 October following the tax year to which the return relates, if earlier.

The payment date for any capital gains tax due is the same day on which the return is due.

QUESTION NO. 7

CANDIDATE NO. ...

Cara - Death Estate

Family Home	£2,000,000	
Less: loans outstanding	(£700,000)	
Agricultural land	£400,000	
Less: APR @ 100%	(£25,000)	$\frac{400,000 - 300,000}{400,000} =$
Shares in KO Ltd	£500,000	
Less: BPR @ 100%	(£20,000)	$0.25 \times £100,000$
Cash and personal possessions	£350,000	
		$\frac{500,000 - 400,000}{500,000}$
Net Estate	£2,505,000	$0.2 \times £100,000$

Less: NRB at date of death (£325,000)

Chargeable to IHT £2180,000

IHT @ 40% £872,000

The loans have been used to buy property which qualifies for relief @ 100% as a result of both BPR and APR. The restriction applied therefore relates only to the value of the land which is not subject to the loan, and similarly for the proportion of the shares which are actually held by the deceased, not those which are technically still attributable to the loan.

Part I

QUESTION NO. 8

CANDIDATE NO. ..

When a UK domiciled individual leaves the UK and acquires a domicile of choice outside of the UK, they will no longer have their death estate subject to IHT on their worldwide assets. Instead, IHT will only be suffered on the value of their UK assets.

They will also no longer be able to receive an unlimited spousal exemption on gifts from a UK domiciled spouse, and will instead be limited to £325,000 tax free, with any additional gifts being a potentially exempt transfer. This will become chargeable to IHT in the event that the donor dies within 7 years.

The non-UK domiciled individual may re-elect to be treated as UK domiciled for IHT purposes.

QUESTION NO. 9

CANDIDATE NO.

Interest free inheritance tax instalments refers to the fact that where IHT is payable by instalments, for the purposes of any interest to be added to each instalment, it shall be treated as carrying interest only from the date at which the instalment is payable. Essentially therefore, there is no charge for paying by instalments.

The due dates for instalments are:

- the first is due on the date that the full IHT amount would have been due, i.e. 6 months following the end of the month in which the deceased's death occurred; and
- annually thereafter.

Part I

QUESTION NO. 10

CANDIDATE NO. ..

1) Transfer of £800,000 to trust - IHT payable by Rancho Ltd

$$\text{IHT @ 20\%} = £160,000$$

2) The IHT due by each participant

Michael 88% £140,800

Hussein 8% £17,800

Linda 4% £6,400

£160,000

1) Harold Bunnings
Death Estate

Family Home	£500,000
Less: Spousal exemption	(£500,000)
Share in unquoted trading Co.	£200,000
Less: BPR @ 100%	(£200,000)
Cash, quoted shares & personal possessions	£500,000
Less: charitable donation (exempt)	(£50,000)
Net estate	<u>£450,000</u>

Less: NRB £325,000	
Less: transfer in prior 7 yrs (£125,000)	
NRB remaining	(£200,000)
Chargeable to IHT	<u>£250,000</u>

Baseline amount = £250,000 + £50,000 = £300,000
 10% = £30,000 < £50,000
 ∴ reduced rate applies.

2) IHT due = £250,000 @ 36% = £90,000

Part I

QUESTION NO.12.....

CANDIDATE NO. ...

The penalties which could be applied for the incorrect return are:

- 100% of the tax due if the error was deliberate & concealed.
- 70% of the tax due if the error was deliberate but not concealed
- 30% of the tax due if the error was careless

However, HMRC may choose to waive the penalty in certain circumstances, for example, if it is fair to do so:

The fact that this was simply an error in when to report the gain, and that the executor did later report it, should enable HMRC ^{to see} that the error was not ~~deliberate~~ deliberate. However, it is

clear that more care should have been taken in establishing when the correct reporting deadline was.

Firm Address

Client Address

Date

Dear Mr. Butler,

Personal Tax Affairs

Thank you for your recent letter. Please see below my comments with regards to each of your queries.

1. With regards to the gift you wish to make to your granddaughter the inheritance tax consequences of making this gift would be that £2,000 of the gift would be exempt from inheritance tax (IHT) purposes, as gifts on marriage up to specific amounts (dependent on who the donor is) are exempt transfers.

Any amount you wish to gift in excess of this amount will constitute a potentially exempt transfer (referred to as a PET). This means that should you survive for 7 years after making the gift, the gift will be free from IHT. You may also know that in order to reduce the value of the gift, all individuals have an annual exempt amount for IHT purposes of £3,000. It is possible to carry forward a years exemption so that in one year you have £6,000 worth of exemption. Therefore, the tax exempt gift you could make to your granddaughter on her wedding would total £8,000. As I previously mentioned, any amount in excess of this would constitute a PET and would only become chargeable to IHT in the event of your death.

No lifetime tax would be payable, though the death rate of 40% would apply. However, a relief known as taper

QUESTION NO.!

CANDIDATE NO.

relief may be available in the event that you survive for between 3 and 7 years after making the gift. The relief reduces the amount of IHT payable by a set percentage. Any IHT payable in the event of your death on the gift would be payable by your granddaughter, unless you specified otherwise in your will.

2) Discretionary trusts are taxed at the rates applicable to trusts. These rates are 45% on non-savings & savings income, and 37.5% on dividends.

This differs to interest in possession trusts which are taxed at the lower rates of 20% on non-savings and savings income, and 10% for dividends.

The income is taxed on the trustees and you receive a tax credit on any tax paid by the trustees. From discretionary trusts, you are deemed to receive income net of 45% tax. If you are a lower or higher rate taxpayer, you may be able to claim the additional tax back.

3) A discretionary trust is taxed as a settlor interested trust when the settlor still derives some benefit from the trust property.

The settlor will be taxed as though all income is received directly by them, rather than the trustees.

If the settlor's children under the age of 18 are also beneficiaries, they can receive income of up to £100 each. Anything in excess of this amount will be taxed on the settlor.

QUESTION NO. 1

CANDIDATE NO.

5) With regards to your complaint regarding one of the trustees, I thought I would outline the situations in which a breach of trust may occur.

The circumstances include when the trustee acts out of line in accordance to the trust deed or by way of his behaviour. Examples would include profiting from his position as a trustee when not permitted, as in the case here, or paying money to the wrong beneficiary.

If the trustee goes against the trust deed, the remedies available for the beneficiaries are to either reclaim the trust property which has been misappropriated, or if that is not possible, they may claim damages from the trustee themselves.

A trustee who breaches the terms of the trust may also be removed from his position either by a court order, or by the beneficiaries electing for it to happen. All beneficiaries must be sui juris, meaning over 18 and of full mental capacity.

6) A fee retainer arrangement is one where a single fee is agreed for the work completed between an advisor and their client which essentially means all work done is paid for by the all encompassing fee.

In terms of what we would need to agree it would be necessary to state exactly what work is covered by the retainer in the engagement agreement. I would need this to be very clear, as both of us need to know the limits to the services I provide. For professional reasons it would be inappropriate for me to agree this if it meant I was unable to service the requirements of my other clients.

Please do let me know if this is something you would like to pursue.

Yours sincerely,

An Advisor.

Part II

QUESTION NO. 2.....

CANDIDATE NO. ...

Jacob - May 2011

1) Lifetime Gifts

Gift to goddaughter on 31/7/08	£187,000
Less: Annual exemptions x 2	(£6,000)
PET (no lifetime tax)	£181,000

Gift to trust on 1/3/09	£625,000
Less: A£	(£6,000)
CLT	£622,000

Less: NRB at date of gift	(£312,000)
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Chargeable to IHT	£310,000
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IHT @ 20%	<u>£62,000</u>
	paid by trustee.

Death tax on lifetime gifts

Gift to goddaughter	
PET (now chargeable)	£181,000
Less: NRB	(£325,000)
Chargeable to IHT	Nil

Gift to trust	
CLT	£622,000
Less: NRB remaining	
(£325,000 - £181,000)	(£144,000)

Chargeable to IHT	£478,000
IHT @ 40%	£191,200
Less: taper relief 60%	(£114,720)
(between 5 & 6 years)	

	£76,480
Less: credit for lifetime tax	(£62,000)

QUESTION NO. 2

CANDIDATE NO.

IHT now due

£14,480

2) Death estate

House	£800,000
Less: mortgage	(£500,000)
Chattels	£30,000
Insurance policy proceeds	£600,000
Works of art (national heritage)	£200,000
Less: conditional exemption	(£200,000)
Investments	£300,000

Less: Funeral expenses (£4,000)

Income tax (£7,810)

w1.

Net estate £1,218,190

w1 - with regards to the tombstone expense, this is not deductible as it is not a reasonable funeral expense.

- with regards to the loan of £500, there was no legal obligation to pay and therefore it is not deductible.

no NRB remaining as used on lifetime gifts.

IHT due = 40% = £487,276

QUESTION NO. 2

CANDIDATE NO.

3) Income tax payable

	Non-savings	Savings	Dividend
Employment income	£800		
ISA interest ($2160 \times 100/80$)		£2700	
Dividend ($3,000 \times 100/90$)			£3,333
Taxable	£800	£2700	£3,333

Expenses ($1200 \times 100/90$)

£1,333

Admin expenses ($500 \times 100/90$)

£556

Tax

~~£1000 @ 20% =~~

£3,500 @ 20% = £700

£3,333 @ 10% = £333

£1033

Less: dividend tax

credit (£333)

expenses tax

credit (£389)

interest tax

credit (£540)

Total tax repayable £229

4) The executor will be treated as having made a disposal for CGT purposes and will be chargeable to CGT on the gain arising from the disposal.

5) An executor is somebody who is chosen to administer the estate of a deceased individual in the will of the deceased.

An administrator is somebody who is appointed to administer the estate in the absence of a will.

6) Four recommended clauses to include in a disengagement letter:

- When the advisor will officially cease as being the advisor and where their liability stops:
- Clarification of any matters which remain outstanding
- Clarification on the position of fees and what is outstanding.
- Request for any new advisor details so that the appropriate information can be passed to them.

QUESTION NO. 3

CANDIDATE NO.

1) The due date for a paper tax return is by 31 October 2015.

Income tax - IIP settlement			
Y/e 5 April 2015			
	Non-savings	Savings	Dividend
Rental income ($9 \times £1000$)	£9,000		
Interest (£650 $100/80$)		£650	
Dividend ($£1000 \times 100/90$)			£1111
Tax @ 20%	£1800	£130	
Tax @ 10%			(£111)
Total tax due =	<u>£1930</u>		

2) As Sophie receives income as the life tenant, she is treated as having received the income net of tax. She will be able to claim a tax credit for any income tax paid by the trustees.

QUESTION NO. 3

CANDIDATE NO. .

3) Capital Gains tax payable 2014/15

- Shares in Echo Ltd

Proceeds	£500,000
LESS: cost	(£320,000)
Gain	£180,000

w1.

Chargeable £180,000

CGT @ 10% £18,000

Assuming entrepreneurs' relief claimed by Sophie and the trustees

- Land

Proceeds	£280,000
LESS: cost of sale	(£3,500)
LESS: cost	(£230,000)
Gain	£46,500

LESS: annual exemption (£5,500)

Chargeable £41,000

CGT @ 28% £11,480

w1. Annual exemption not used for the shares as there is a 10% relief for entrepreneurs' relief and will therefore only suffer CGT @ 10%. Used instead for the disposal of land which only suffers CGT @ 28%, therefore reducing the total amount of CGT owing.

4) If the proceeds of sale from the land and shares are distributed to Jophie, it will not trigger any exit charges. If the trust was created on or after 22 March 2006, the trust would not have been a qualifying interest in possession trust and would instead be a relevant property trust. This would mean that the trust would begin to suffer principle and exit charges on every 10 year anniversary and everytime income was distributed.

5) The trustees have a right of ~~possession~~ ownership whereas the life tenant has a right of possession. This means that they have a right of present enjoyment of the property, but not the legal ownership, which is what the trustees have. The remainderman has a right to enjoyment of the property when the life tenant dies. They will then take the legal ownership from the trustees.

6) Additional trustees can be appointed when:

- it becomes necessary to do so due to the removal of a former trustee for breach of trust;
- if a particular person has the required skills to deal with the trust property and the appointment is necessary for the benefit of the trust.
- when a former trustee retired from their position.