May 2015 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. You are not permitted to write in the answer folders. The Presiding Officer will inform you when you can start writing. Calculators may not be used during this time.

- You are provided with two answer folders (one for each part of the paper). You must put your candidate number on the front cover of both folders.

- You must write your answers on the paper provided. Please start each answer on a new sheet of paper and write on one side of the paper only. Put your candidate number at the top of each page and make sure you place your answers in the correct answer folder.

- All workings should be shown and made to the nearest month and pound unless the question requires otherwise.

- There are alternative parts in Part II questions 2 and 3 for Scots Law candidates.

Part I

You must use the Part I answer folder.

1. Terry died on 8 May 2007 leaving his estate, valued at £400,000, equally between his widow Catherine and daughter Kate. In July 2005, Terry had gifted £20,000 to Kate, but apart from using his annual exemptions, he had made no other lifetime gifts.

   Catherine died on 6 December 2014 leaving her entire estate valued at £800,000 to her grandchildren. Catherine did not make any lifetime gifts.

   1) Calculate Terry's unused nil rate band allowance following his death. (2)

   2) Calculate the Inheritance Tax payable as a result of Catherine's death. (2)

2. Abdul died on 19 March 2012 leaving a complicated estate. In order to meet the ongoing professional costs, the executors sold the following assets from the estate:

Disposal date	Asset	Probate value	Disposal proceeds
		£	£
2 May 2013	Shares in ABC Ltd	12,000	19,000
16 June 2014	Shares in DEF plc	40,000	48,000
21 July 2014	Gilts	11,000	11,500

   Calculate the executors' liability to Capital Gains Tax in the 2013/14 and 2014/15 tax years as a result of these disposals. (Assume 2014/15 rates and allowances apply to both years.) (3)

Use the following information for questions 3 and 4

Rudolph created a discretionary trust on 27 October 2004 with £400,000 in cash, which the trustees used to buy shares in Ice plc. He had made no previous lifetime transfers.

Rudolph added a further £300,000 cash to the trust on 12 September 2011, which the trustees then used to purchase an investment property.

On 27 October 2014 the value of the Ice plc shares was £580,000 and the value of the investment property was £345,000.

The trustees have not made any capital distributions to date but they intend to distribute the investment property to a beneficiary on 12 May 2020. You should assume the value of the property at the date of distribution will be £395,000 and the nil rate band allowance in 2020/21 will be £350,000.

3. **Calculate, showing all your workings, the trust's 10 year anniversary Inheritance Tax charge arising on 27 October 2014 and state the deadline for submission of form IHT100.** (4)

4. **Calculate, showing all your workings, the Inheritance Tax exit charge arising as a result of the distribution in 2020. You should assume the beneficiary will pay any tax arising.** (3)

5. The Finnick Discretionary Trust received net dividends of £6,000 during 2014/15.

   The trustees made a net income payment of £1,650 to Finley, a beneficiary, on 31 March 2015. The trust had a tax pool balance brought forward at 6 April 2014 of £950. No other trusts had been created by the settlor.

   Calculate the trust's tax pool balance at the end of the 2014/15 tax year. (4)

6. When trustees dispose of capital assets, they must usually inform HM Revenue & Customs and calculate their liability to Capital Gains Tax accordingly.

   Explain when and how trustees should report capital disposals to HM Revenue & Customs. Your answer should include the deadline for reporting capital gains and the payment date for Capital Gains Tax liabilities. (3)

7. Cara died on 1 July 2015, leaving her entire estate to her children. She had made no lifetime transfers and at her death she owned the following assets:

	£
Family home	2,000,000
Agricultural land	400,000
Shares in KO Ltd, an unquoted trading company	500,000
Cash and personal possessions	350,000

   The agricultural land was acquired in 2007 with a loan of £300,000 secured on the family home. The land is let to a farmer who uses it for agricultural purposes, and a new lease was signed in 2012.

   The shares in KO Ltd were acquired on 3 June 2013 using a loan of £400,000 also secured against the family home.

   Both loans remained outstanding at death.

   Calculate the Inheritance Tax liability arising as a result of Cara's death, briefly explaining your treatment of the two loans. (4)

8. It is possible for a UK domiciled individual to leave the UK permanently and acquire a domicile of choice outside of the UK.

   Explain the Inheritance Tax consequences of an individual who has been domiciled in the UK acquiring a new domicile of choice overseas. (2)

9. In certain circumstances, a claim may be made to pay Inheritance Tax in instalments.

   Explain what is meant by 'interest-free' Inheritance Tax instalments and the due dates for payment. (3)

10. Rancho Ltd is a close company with three participators. The share capital is held as follows:

Michael	88%
Hussein	8%
Linda	4%

In January 2015 the company created a discretionary trust with £800,000 cash for the benefit of the senior members of the sales force.

1) Calculate the Inheritance Tax payable by Rancho Ltd in respect of this transfer. (Ignore annual exemptions and the nil rate band.) (1)

2) Calculate the Inheritance Tax due by each of the participators should the company fail to pay this liability. (2)

11. Harold Bunnings died on 14 September 2014 leaving an estate as follows:

	£
Family home	900,000
Shares in an unquoted trading company owned for many years	200,000
Cash, quoted shares and personal possessions	500,000
Gross estate	£1,600,000

His chargeable lifetime transfers in the seven years prior to his death totalled £125,000.

Harold's will directed that the family home should be left to his wife, £50,000 cash to a registered charity and the residue of his estate split between his two children.

1) Calculate the 'baseline amount' to determine if the estate is eligible to pay the reduced rate of Inheritance Tax. (3)

2) Calculate the Inheritance Tax due as a result of Harold's death. (1)

12. Mrs Button died back in 2010, but her estate is still being administered.

A capital gain arose on 3 April 2013, which was included in the estate accounts but not on the 2012/13 tax return. This is because her executors considered the tax liability to be small and, as they didn't have the details to hand when completing the 2012/13 tax return, they included it on the 2013/14 tax return instead.

HM Revenue & Customs have now opened an enquiry into the 2012/13 tax return on the basis that they have information that there has been a capital gain which should have been included.

Explain the penalties which could be applied by HM Revenue & Customs. (3)

Place your answers for Part I in the Part I answer folder.

Part II

You must use the Part II answer folder.

Marks are specifically allocated for appropriate presentation.

1. You have received the following letter from Mr Butler, a long standing client.

   'Dear Adviser

   As you are aware, my tax affairs are complex and I would appreciate your advice on the various aspects listed below.

   Firstly, I am considering making a substantial gift directly to my grandchild who is getting married shortly. Can you please confirm the Inheritance Tax aspects that could affect me personally?

   Regarding my trusts, I still find the taxation position confusing as I am excluded from benefiting from some of my trusts but I can benefit from others. I would appreciate further clarification of the position, especially in respect to Income Tax and Inheritance Tax.

   In addition, one of the trustees does very little, but is proposing to charge for his services and trustees' remuneration is not permitted in the trust deed. If the trustee goes against the terms of the trust deed, are there any remedies available to the beneficiaries?

   Finally, a friend has mentioned that he has a 'retainer arrangement' with his tax adviser. Given the number of letters I send to you with queries like these, I wonder if this is something we should explore. Perhaps you could let me have some more detail.

   Thanks in advance.

   Yours sincerely

   Mr Butler'

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

   1) **Explain the Inheritance Tax consequences for Mr Butler if he makes a potentially exempt transfer to his grandchild.** (4)

   2) **Explain how discretionary trusts are taxed for Income Tax purposes. You should assume the trust is not settlor-interested.** (4)

   3) **Explain when and how a discretionary trust is taxed as a settlor-interested trust for Income Tax purposes.** (4)

   4) **Explain when and how a discretionary trust is taxed as a settlor-interested trust for Inheritance Tax purposes.** (2)

   5) **Explain what the term 'breach of trust' means and explain two remedies available to beneficiaries to recover any losses suffered as a result of a breach of trust.** (3)

   6) **Explain what is meant by a fee retainer arrangement and the terms normally included in an engagement letter in respect of a retainer**

arrangement. (3)

Total (20)

2. Jacob died on 11 May 2014. In his lifetime he made the following gifts:

(a) Cash gift to his goddaughter on 31 July 2008 of £187,000.

(b) Settled cash of £625,000 upon trust for his goddaughter on 1 March 2009. The trustees paid the Inheritance Tax due. The trustees invested the cash in a property and, by the time of Jacob's death, the property was worth £700,000.

When Jacob died his estate consisted of the following:

	£
House	800,000
Chattels	30,000
Works of art (conditions for national heritage property are met)	200,000
Investments	300,000

There was a mortgage secured on the house of £500,000. Jacob took out an insurance policy four years ago which paid out £600,000 to his executors on death.

The executors incurred costs of £4,000 for the funeral and £5,000 for the tombstone. The executors honoured an informal oral agreement with Jacob's friend and repaid a cash loan of £500. Income Tax of £7,810 was due on 31 January 2014 but remains unpaid.

During the period to 5 April 2015 the executors received the following income:

	£	
ISA interest	2,160	
Employment income (paid 30 May 2014)	800	(no tax deducted)
Dividends (net)	3,000	

The executors took out a one year loan to help fund the Inheritance Tax payable. Interest was paid on 31 March 2015 of £1,200. The executors also incurred costs of £500 in administering the estate.

The executors sold a car on 8 January 2015 for £12,000 (probate value was £10,000). They also sold an antique dresser on 1 February 2015 for £5,000 (probate value was £4,500).

The executors have indicated that they now feel confident finalising the administration of the estate themselves and have no further need for the services of your firm of tax advisers.

Continued

2. *Continuation*

You are required to:

1) **Calculate the Inheritance Tax payable on the lifetime gifts during lifetime and as a result of Jacob's death.** (6)

2) **Calculate the Inheritance Tax payable on Jacob's death estate.** (5)

3) **Calculate the Income Tax payable by/repayable to Jacob's executors for 2014/15.** (4)

4) **Explain the Capital Gains Tax position for Jacob's executors for 2014/15.** (1)

5) **Explain the difference between an executor and an administrator.** (2)

[Alternative for Scots Law candidates:

5) ***Explain the difference between an 'executor-nominate' and an 'executor-dative'.*** *(2)****]***

6) **State four of the recommended clauses to include in a letter of disengagement when ceasing to act for a client.** (2)

Total (20)

3. The Barlow Interest in Possession Settlement was created on 8 October 1999. This is the only trust ever created by the settlor. The life tenant, Sophie, receives quarterly income payments from the trustees. As well as the income from the settlement, Sophie receives a salary and dividends from Echo Ltd, a company where she has worked for many years. Sophie owns a 20% shareholding in Echo Ltd, whilst the trustees own a 2% shareholding.

Neither Sophie nor the trustees have ever claimed entrepreneurs' relief and Sophie has confirmed that she would be happy to join with the trustees in any claims required to reduce the amount of tax payable by the trustees.

The initial trust property was as follows:

	Market value at 8 October 1999
	£
Cash	20,000
Land	230,000
2% shareholding in Echo Ltd	320,000

On 1 August 2014 the trustees sold their shareholding in Echo Ltd for £500,000.

The land was also sold on 6 December 2014 for £280,000. Professional costs of £3,500, including VAT, were incurred in connection with the sale. The land was let for £1,000 per month until it was sold. It has never been used for business purposes.

Gross bank interest was received during the year ended 5 April 2015 totalling £650. The trustees received a dividend in respect of their shareholding on 5 May 2014 of £1,000 (net).

Continued

3. *Continuation*

You are required to:

1) **Calculate, showing all your workings, the Income Tax payable by the trustees for 2014/15 and state the due date for a paper tax return to report this income.** (3)

2) **Explain the Income Tax consequences for Sophie of receiving income as the life tenant.** (2)

3) **Calculate the Capital Gains Tax payable by the trustees for 2014/15, clearly explaining your treatment of the annual exempt amount.** (5)

4) **Explain the Inheritance Tax implications if the proceeds from the sale of the shares and land are distributed to Sophie. Explain how the position would be different if the settlement had been created after 22 March 2006.** (4)

5) **Explain the type of ownership the Trustees, Life Tenant and Remaindermen have in a Life Interest Trust.** (3)

[Alternative for Scots Law candidates:

5) ***Explain the type of ownership the Trustees, Life Renter and Fiar have in a Life Interest Trust.*** *(3)]*

6) **Statutory powers in the Trustee Act 1925 facilitate the appointment of new or additional trustees. State three scenarios when these powers can be used.** (3)

[Alternative for Scots Law candidates:

6) ***Statutory powers in the Trusts (Scotland) Act 1921 allow the courts to appoint new trustees. State three scenarios when these powers can be used.***

(3)]

Total (20)

Place your answers for Part II in the Part II answer folder.