Practical Tax People

Association of Taxation Technicians

May 2015 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part II Suggested Solutions

Question 1

A Adviser
Address

Mr Butler
Address

Date

Presentation – 1 Mark

Dear Mr Butler

Thank you for your recent letter. I will refer to each query raised in turn.

Inheritance Tax consequences of a potentially exempt transfer

During your lifetime, the transfer would be treated as exempt for inheritance tax purposes (1/2) so there is no immediate inheritance tax liability. (1/2). If available, the marriage exemption of £2,500 (1/2) and annual exemption(s) of £3,000 per annum are allocated to the potentially exempt transfer (1/2) when calculating the transfer of value. (1/2)

If you survive seven years from the date of the transfer, there are no further inheritance tax implications. (1/2)

However, if you die within seven years of the transfer, it becomes a chargeable transfer (1/2) and it will use some/all of your available nil rate band (1/2) and therefore your nil rate band will not be fully available to offset against your death estate. (1/2)

(part 1 max 4, including presentation mark)

Income Tax treatment of discretionary trusts

Income falling within the standard rate band of £1,000 (1/2) is taxed at the basic rate. This being 10% for dividends and 20% for savings and non savings income. (1/2)

The standard rate band is divided by the number of settlements made by the same settlor (1/2) with a minimum of £200 for each trust. (1/2)

Remaining income is taxed at the rate applicable to trusts. (1/2) For the 2014/15 tax year this is 37.5% on dividends and 45% on other income (1/2).

Expenses relating to a specific source of income are deducted from that income to reduce the amount liable to tax. (1/2)

Trust management expenses are grossed up (1/2) and deducted from gross trust income. (1/2) They are set against dividend income in priority to other sources. (1/2)

Income used to pay the expenses is taxed at the basic rate rather than the rate applicable to trusts. (1/2)

(part 2, max 4)

Settlor-interested trusts – Income Tax

For income tax purposes, a settlor-interested trust is a trust from which the settlor and/ or their spouse/civil partner (1/2) can benefit.

The trustees of a settlor-interested discretionary trust are responsible for paying income tax based on normal discretionary trust income tax rules (1/2).

The settlor will then be taxed on the trust's income at their marginal rate for that type of income (1/2), even if the income is not distributed to them. (1/2)

No deduction is allowed for any trust management expenses when calculating the settlor's liability. (1/2)

The settlor is given credit for the tax that has been paid on the trust income by the trustees. (1/2) However, if the settlor is due a tax refund on this income, this must be repaid to the trustees. (1/2)

Similar provisions also apply where the trust is for the benefit of the settlor's minor child (1/2) or step-child and income is paid to them. (1/2)

(part 3, max 4)

Settlor-interested trusts – Inheritance Tax

For inheritance tax purposes, a settlor-interested trust is a trust from which the settlor can benefit. It does not matter if the settlor's spouse/civil partner can benefit or not (1/2).

The gifts with reservation of benefit rules will apply (1/2) so the assets in the trust are treated as if the settlor still owns them i.e. they are still in his estate for inheritance tax purposes. (1/2)

The transfer to create the trust is still a chargeable lifetime transfer (1/2) and the trustees are still liable to exit and 10 yearly inheritance tax charges. (1/2)

In some scenarios double taxation can arise and a form of double taxation relief is available. (1/2)

(part 4, max 2)

Breach of trust

A breach of trust arises where trustees fail to carry out their duties in accordance with the terms of trust deed or the law, or because of their conduct. (1)

In the event of a breach, the beneficiaries can recover trust property that still exists and is identifiable in the hands of the trustees or other persons who have received it. (1)

Alternatively, or in addition, the beneficiaries can claim damages from the trustees, who are in the first instance personally liable for any loss not recovered through an action to recover trust property. (1)

(part 5, 3)

Retainer Arrangements

A retainer arrangement means that a member may charge, or accept, fees from a client simply for the retention by that client of the member's services, whether or not additional fees will be charged for specific services which may subsequently be rendered. (1)

Any retainer arrangement should normally be set out in writing in the letter of engagement, with a view to ensuring that the member and the client clearly understand the extent, and the limitations, of the arrangements. (1)

In particular, such a letter of engagement should make it clear the point at which further charges may be levied. (1)

The letter of engagement will normally also contain a provision for terminating the arrangements in the event of a conflict of interest. (1)

(part 6, max 3)

I trust that this answers your queries. Please let me know if I can be of further assistance.

Yours sincerely

A.T. Adviser

NB Credit given for other valid points throughout the question. Total 20

Question 2

2.1 Tax payable during lifetime:

	£	
Gift 31 July 2008		
PET so no lifetime tax due	Nil	(1/2)
Gift 1 March 2009		
CLT	625,000	
Less: annual exemption(s)*	NIL	(1/2 if state not available)
Less: nil rate band 2008/09	(312,000)	(1/2)
	313,000	
Tax payable @ 20%	62,600	(1/2)

* Annual exemptions allocated to PET even though no lifetime IHT payable

Tax payable as a result of Jacob's death:

	£	
PET 31 July 2008	187,000	
Less: Annual exemptions	(6,000)	(1/2) for both 2007/08 & 2008/09
Less: Nil rate band (restricted)	(181,000)	(1/2)
Chargeable	NIL	
CLT 1 March 2009	625,000	(1/2)
Less: nil rate band remaining	(144,000)	(1/2)
Ie £325,000 - £181,000		
	481,000	
Tax payable @ 40%	192,400	(1/2)
Taper relief:		
01/03/09 – 11/05/14 = 5 – 6 yrs		(1/2)
Relief at 60%	(115,440)	(1/2)
	76,960	
Less: lifetime tax paid	(62,600)	(1/2)
Tax payable	14,360	

(6)

2.2

	£	£	
House	800,000		
Less: mortgage	(500,000)		(1/2)
		300,000	
Insurance proceeds		600,000	(1/2)
Works of art		NIL	(1/2)
Chattels		30,000	}(1/2) for both
Investments		300,000	}
		1,230,000	
Income tax payable	7,810		(1/2)
Funeral costs	4,000		}(1/2) for both
Tombstone	5,000		}
Debt	NIL		(1/2) if state not deductible *
Executors' costs	NIL		(1/2) if state not deductible**
		(16,810)	
		1,213,190	
Less: nil rate band		NIL	(1/2) used in lifetime
		1,213,190	
Tax payable @ 40%		485,276	(1/2)

* Debt of £500 not deductible as not legally enforceable
** Executor administration costs of £500 not deductible as incurred personally

(5)

2.3

	£	£	£	£	
ISA interest (£2,160 @ 100/80)		2,700			(1/2)
Employment income	800				
Dividends (£3,000 @ 100/90)			3,333		(1/2)
	800	2,700	3,333		
Less: Interest paid	(800)	(400)			(1/2) (1/2)
	NIL	2,300	3,333		
Tax @ 20%		460			}(1/2) for both
Tax @ 10%			333		}
				793	
Less:					
tax at source	£3,333 @ 10%			(333)	(1/2)
	£2,700 - £2,160			(540)	(1/2)
Tax refund due				(80)	(1/2)

(4)

2.4 There is no capital gains tax payable on the sale of the car as it is an exempt asset (1/2)
There is no capital gains tax payable on the sale of the antique dresser as it is covered by the chattels exemption (1/2)

(1)

2.5 An executor is a personal representative appointed by a valid will. (1)
An administrator is a personal representative appointed by the court in the absence of a valid will or where the executor(s) under a will do not take out a grant of representation. (1)

(2)

2.5 Scots Law alternative

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

(2)

2.6 Any four of the following:

- A summary of services provided up to the date of ceasing to act (1/2)
- Note of any further action to be taken by the member (1/2)
- A note of outstanding matters that either the ex-client or the new advisors will need to address (1/2)
- Details of any impending deadlines and the action required (1/2)
- The member's willingness or otherwise to assist the new advisor to resolve outstanding issues with HM Revenue & Customs or others (1/2)
- The member's willingness or otherwise to provide copy papers to the new advisors (1/2)
- Details of outstanding fees (1/2)
- A note indicating whether the member or his successor is to advise HMRC of the change (1/2)

(max 2)

Credit given for other valid points throughout the question. Total 20

Question 3

3.1

	Non savings income	Savings income	Dividends	Total	
	£	£	£	£	
Bank interest		650			
Dividends					
£1,000 x 100/90			1,111		(1/2)
Rental £1,000 x 8	8,000				(1/2)
	8,000	650	1,111		
Tax:					
£8,000/£650 @ 20%	1,600	130			(1/2)
£1,111 @10%			111		(1/2)
	1,600	130	111	1,841	
Tax deducted at source				(111)	(1/2)
Tax payable				1,730	

The due date for a paper return is 31 October 2015. (1/2)

(3)

3.2 The income paid to Sophie retains its nature i.e. savings, dividends or non-savings (1/2) and these amounts are included on her tax return (1/2) and will be taxed at her marginal rate of income tax (1/2).

So that she can complete the tax return, she will receive form R185 which summarises the net amount of income she is entitled to for the year (1/2) alongside associated tax credits (1/2). The net amount of income is the income for the year after deducting tax at basic rates and expenses settled out of the income (1/2).

Credit will be given for any other valid points. Max (2)

3.3

	£	
Proceeds	500,000	
Less: cost	(320,000)	(1/2)
	180,000	
Tax payable @ 10%	18,000	(1/2)

	£	
Proceeds	280,000	
Less: costs of sale	(3,500)	(1/2)
	276,500	
Less: cost	(230,000)	(1/2)
	46,500	
Annual exempt amount	(5,500)	(1)
	41,000	
Tax payable @ 28%	11,480	(1/2)

The annual exempt amount is allocated in the most beneficial way, (1/2) so is first set against gains having the highest rate of CGT, being the gains on the sale of the land. (1/2)

This is because the Trustees will be entitled to claim part of Sophie's entrepreneurs' relief allowance since Sophie, being the life tenant, personally owns at least 5% of the company personally and she is also an employee. (1/2)

(5)

3.4 As the trust is a qualifying interest in possession trust (1/2), the trust property is treated as part of Sophie's estate for inheritance tax purposes. (1/2) If the sale proceeds are distributed to her, they move from being part of her settled estate (1/2) to part of her free estate which is liable to inheritance tax (1/2). An appointment out to Sophie therefore has no inheritance tax implications. (1/2)

If the settlement was created after 22 March 2006, it would be a relevant property trust. (1/2) The value of the trust is not treated as part of Sophie's estate for inheritance tax purposes (1/2). If an appointment is made to Sophie it would be an event for inheritance tax purposes and would be subject to an exit charge (1/2). Thereafter, the sale proceeds would be liable to inheritance tax as part of her estate (1/2).

Max (4)

3.5 Trustees are the legal owners of the trust property (1/2). Assets will be registered in their names and they will have control over them. (1/2)

The life tenants are the beneficial owners, (1/2) with an entitlement to use the trust property and all net income arising during their lifetimes. (1/2)

The remaindermen are also beneficiaries, but their interest in the property is subject to the life tenant's interest so they will only receive the trust fund on the life tenant's death. (1)

(3)

3.5 Scots Law alternative

Trustees are the legal owners of the trust property (1/2). Assets will be registered in their names and they will have control over them (1/2)

The life renters are the beneficial owners, (1/2) with an entitlement to use the trust property and all net income arising during their lifetimes (1/2)

The Fiars are also beneficiaries but their interest in the property is subject to the life renter's interest so they will only receive the trust fund on the life renter's death (1)

(3)

3.6 Any three of the following:

- A trustee dies (1)
- A trustee remains outside the UK for 12 months (1)
- A trustee wishes to retire (1)
- A trustee refuses to act (1)
- A trustee is unfit to act (1)
- A trustee is incapable of acting (1)
- A trustee is removed under a power in the trust instrument (1)

Max (3)

3.6 Scots Law alternative

Where a trustee cannot be appointed under the trust deed (1)
The sole trustee is incapable of acting (1)
The sole trustee has been absent from the UK for six months. (1)

(3)

NB Credit given for other valid points throughout the question. Total 20