May 2022 Examination

PAPER 5

Inheritance Tax, Trusts & Estates

Part I Suggested Answers

Candidates will be given credit for relevant points not on the mark scheme.

1.

The executors of Matilda's estate can make an informal payment for the period of administration as the following conditions apply (1 mark for each of the following):

- The total Income Tax and CGT due by the Estate is less than £10,000
- The administration is completed within two years of death
- The probate value of the estate is less than £2.5million
- The proceeds for the assets sold, the holiday home, are less than £500,000
- The estate is not complex e.g., does not involve an ongoing trust, and
- HMRC has not issued a trust and estate self-assessment tax return

Total Max (4)

2.

As Jason is non-UK domiciled (1/2), the general rule is that he is only subject to UK Inheritance Tax on transfers of assets that are situated in the UK (1/2).

The paintings are not liable to UK inheritance tax as chattels are situated in the place they are physically present and therefore these are situated outside of the UK and are excepted assets (1/2).

The UK foreign currency account is liable to UK Inheritance Tax as money held in a bank account is usually treated as situated in the place that the bank is located i.e., within the UK. The exemption relating to foreign currency accounts applying to non-resident and non-domiciled individuals does not apply as Jason is UK resident at the time of his death. (1/2).

The shares in the open-ended investment company (OEIC) are not liable to UK Inheritance Tax as Jason was non-UK domiciled at the date of transfer and these are therefore excluded property under s. 6(1A) IHTA 1984 (1/2).

The shares in the company listed on the London Stock Exchange are situated where they are listed and are therefore UK assets and will be subject to UK Inheritance Tax (1/2).

Total (3)

3.

1)

The trustee (Tom) legally owns the property within the bare trust (1/2) and conducts the management of these assets on behalf of his grandson (1/2).

Tom's grandson has absolute equitable (or beneficial) entitlement to the assets within the bare trust (1/2) and therefore the income or gains generated from those assets (1/2).

Tom's grandson is therefore directly taxed on the income (1/2) and gains (1/2) of the bare trust.

Max (2)

2)

Income tax due:

	£	
Dividends	40,000	
Less: Personal Allowance	(12,570)	(1/2)

	27,430	
Tax @ 0% (£2,000)	0	(1/2)
Tax at 7.5% (27,430- 2,000)	1,907	(1/2)
Total	£1,907	

Capital gains tax due:

	£	
Chargeable Gain	15,000	
Less: Annual Allowance	(12,300)	(1/2)
	2,700	
CGT at 10%	270	(1/2)

Total Max (2)

4.

The deadline for the trustees to register the trust is 5 October 2021 (1/2). As the trustees' registration is more than six months late (1/2), the penalty that can be applied is either 5% of the tax liability (£125) for the year, or £300, whichever is greater i.e., £300. (1).

Although the trustees are responsible for meeting any legal requirements including the registration of the trust with HMRC, the firm has a duty of care to provide the trust with accurate advice as detailed in the engagement letter, which is likely to include all dealings with HMRC (1).

Marks will be given for other appropriate answers.

Total (3)

5.

Trust value:

	£	
Property	450,000	(1/2)
Accumulated Income*	7,400	
Total Value of Trust Property	457,400	

*Retained income which has not been formally accumulated but has arisen more than five years before the 10-year anniversary is treated as part of the capital of the trust and is subject to the full 10-year charge

		£	
Income arising more than five years before principal charge	4 years at £12,000 per year	48,000	(1/2)
Less tax thereon (W)	4 years at £5,150 per year	(20,600)	(1/2)
Net income distributions (first in, first out)		(20,000)	(1/2)

Total accumulated income	7,400

Working
Calculated at 45% on £11,000, 20% on £1,000 per year = £5,150 per year (1).

Total (3)

6.

As the trust was set-up before 22nd March 2006, the trust is a qualifying IIP (1/2). On Mr. Jones' death the assets in the trust form part of his death estate (1/2) but as it passes to his wife this is not immediately chargeable to Inheritance Tax as it is covered by the spouse exemption (1/2). Mrs. Jones' interest is a transitional serial interest (1/2) as, although Mr. Jones' interest ceased after 6 October 2008, the life interest passed to his spouse and therefore the trust still qualifies as a qualifying IIP (1/2). On Mrs. Jones' subsequent death, the assets in the trust will form part of her respective death estate (1/2).

As a qualifying IIP the trust is not subject to exit or principal charges (1/2).

On both deaths, the trustees will be responsible for paying any Inheritance Tax attributable to the trust assets (1/2).

Total Max (3)

7.

The Income Tax payable for 2021/22 is:

	Non-savings	Savings	
	£	£	
Rental Income	25,000		
Interest		1,000	
Less: Annuity (gross)			
12,000 * (100/80)	(15,000)		(1/2)
Income subject to RAT	10,000	1,000	
Tax			
1,000 @ 20%		200	(1/2)
10,000 @ 45%		4,500	(1/2)
Add: Tax deducted from annuity (15,000 x 20%)		3,000	(1/2)
Income Tax liability		7,700	

R185 Net Tax

£	£	
12,000	3,000	(1)

As the trustees initially paid the Income Tax on the annuity, John is not entitled to this repayment and must pass it back to the trustees (1).

Total (4)

8.

The shares in Earthquake Ltd qualify for holdover relief under s 260 TCGA 1992 as the transfer is chargeable transfer for Inheritance Tax. (1)

The warehouse does not qualify for holdover relief under either s.260 TCGA 1992 or s.165 TCGA 1992 as the trust is a settlor interested trust (Benjamin being included in the list of beneficiaries). (1)

The unit trust holdings do not qualify for holdover relief, as the discretionary trust is non-UK resident. Holdover relief is not available on any transfer to a non-resident donee. (1)

The farm buildings and 100 acres of farmland let to a tenant farmer do not qualify for holdover relief under either s.260 TCGA 1992 or s.165 TCGA 1992. Under the Crowe v Appleby principle there is no disposal by the trustees for CGT purposes when a beneficiary becomes entitled to an “undivided share” in land. This is the case here as Benjamin’s youngest son is yet to reach age 25. (1)

Total (4)

9.

	£	
Sale Proceeds	530,000	
Probate Value	(490,000)	(1/2)
Gain	40,000	
PPR relief* (£40,000 x 31/41)	(30,244)	(1/2)
Chargeable gain	9,756	
CGT @ 28%	2,732	(1/2)

Annual exempt amount only available in year of death and the following two tax years, so no annual exemption is available. (1/2)

*The sale qualifies for PPR as Anika lived in the property at Kumar’s death and for some period after. Anika is entitled to more than 75% of the proceeds of the property as specific legatee. (1/2)

As there is a residual liability, the executors must submit a Residential Capital Gains Tax return (1/2) and pay any tax due within 30 days of the completion of the property sale. (1/2)

PPR relief

Actually occupied	23 April 2018 – 23 February 2020	22 months		(1/2)
Deemed occupied	23 December 2020 – 23 September 2021	9 months		(1/2)
Not occupied	23 February 2020 – 23 December 2020		10 months	
Total		31 months	10 months	41 months

Total Max (4)

10.

Transfer into trust:

	£	£	
Transfer of value		500,000	
Nil Rate Band 2021/22	325,000		
Less: Chargeable transfers in previous 7 years	NIL		
		(325,000)	(1/2)
Chargeable transfer		175,000	
IHT @ 20%		35,000	(1/2)

As Rachel is listed as a named beneficiary of the trust, the trust is settlor interested (1/2), and any assets transferred into the trust are taxable in her death estate as a gift with reservation of benefit. (1/2)

As the trust was created within seven years of Rachel's death 'double charges relief' will be available to Rachel to prevent tax being charged on the same assets twice (1/2). HMRC will prepare two IHT computations, one where the asset is treated as within the death estate, and one where the asset is gifted into the trust. IHT will be charged based on the calculation giving the most tax payable (1/2).

Total (3)

11.

Using the loss to donor principle and the related property rules:

	£	£	£	
	Stand alone	Related property	Higher amount	
Value of Ahmad's four chairs before transfer (stand-alone)	25,000			
Value of Ahmad's four chairs before transfer (related property) £80,000 x 25000/(25,000+40,000)		30,769	30,769	(1)
Value of Ahmad's remaining two chairs after transfer (stand-alone)	10,000			
Value of Ahmad's remaining two chairs after transfer (related property) £55,000 x 10000/(10000+40,000)		11,000	11,000	(1)
Transfer of value			19,769	(1)

Total (3)

12.

A fall in value claim cannot be made if the initial gift was cash (1/2)., therefore the house will not qualify for relief. (1/2).

No fall in value claim can be made on the car (1/2) as it is a wasting chattel (tangible, movable property with an expected life of less than 50 years) (1/2).

No fall in value claim can be made (1/2) on the painting as it was sold by Joseph's niece at undervalue (1/2).

Total Max (2)

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Part II Suggested Answers

Candidates will be given credit for relevant points not on the mark scheme.

13. 1)

	Amount of PET / CLT	Utilisation of nil rate band	
	£	£	
1 April 2012 – Blythe Discretionary Trust	300,000		
Less Annual exemption 2011/12	(3,000)		½
Less Annual exemption 2010/11	(3,000)		
CLT	294,000		
Nil rate band	(294,000)	(294,000)	½
Chargeable	nil		
Gifts on marriage, will qualify for varying levels of exemption:			
26 March 2018 - Julia and Ravi – Julia is great-grandchild so exemption of £2,500, no further exemption for Ravi: (£3,000 + £2,500) - £2,500 =	3,000		½
Less annual exemption 2017/18	(3,000)		½
PET	nil		
May 2018 - Gift to Beth			
As the wedding did not take place this cannot be a gift on marriage, therefore no exemption	40,000		½
Less annual exemption 2018/19	(3,000)		½
PET	37,000		
8 January 2019 – creation of GC Discretionary Trust	400,000		
Annual exemption fully utilised	(0)		½
CLT	400,000		
Nil rate band (£325,000 - £294,000)	(31,000)	(31,000)	½
Chargeable	369,000		
IHT @ 20%	73,800		½
Additional transfers should be exempt as they are normal expenditure out of Enid's excess income	nil		½
12 December 2020 – Sale of painting at undervalue			
Although the value of Enid's estate reduced as a result of the gift, the transfer was made without gratuitous intent and is therefore not a transfer of value for IHT	nil		½
Annual gifts to grandchildren:			
Up until end of 2020 each recipient received under £250 per year so small gifts exemption applied.	nil		½
From 6 April 2021 they each received £400 per year so the small gifts exemption does not apply, and the full amount of each gift is chargeable to IHT: £200 x 2 x 10	4,000		½
Less annual exemption 2021/22	(3,000)		
Less annual exemption 2020/21 (restricted)	(1,000)		½
PET	Nil		
Total marks for part 1			(7)

2)

	£	£	
Additional IHT on lifetime transfers on death			
1 April 2012 – Blythe Discretionary Trust - no additional IHT as more than 7 years prior to death – NRB utilisation within 7 years of subsequent transfers remains	Nil	(294,000)	½
May 2018 – Gift to Beth			
Failed PET	37,000		
Nil rate band	(31,000)	(31,000)	½
Chargeable	6,000		
IHT @ 40%	2,400		½
Taper relief @ 20% (3 - 4 years)	(480)		½
IHT payable	£1,920		
8 January 2019 – creation of GC Discretionary Trust			
CLT	400,000		
IHT @ 40%	160,000		½
Less credit for lifetime IHT:	(73,800)		½
IHT payable	£86,200		
Total IHT payable on Enid's lifetime transfers as a result of her death	£88,120		
Total marks for part 2			(3)

Total marks for question 13 **(10)**

14. 1)

	£	£	£	
Current value of settlement		990,000		½
Less Business Property Relief:				
Preference shares in Build Ltd		(60,000)		1
Ordinary shares in Build Ltd – not held for two years		0		1
Less Agricultural Property Relief:				
75 Acres land x £4,000 x 100%		(300,000)		1
			630,000	
Initial value of The Pip Trust, being a related settlement (Imran paid the IHT)			370,000	1
			1,000,000	
Nil rate band 2021/22		325,000		½
Less settlor's CLTs in seven years prior to creation:				
Polly Discretionary Trust	(85,000)			½
Mallow Trust = QIIP so PET not CLT	0			½
Sale of machinery to Build Ltd: Loss to donor = £100,000 - £25,000 =	(75,000)			½
Gift to daughter = PET so not CLT	0			½
Less gross Exits in previous 10 years: £110,000 + £1,751 (trustees paid IHT)	(111,751)			1
		(271,751)		
Nil rate band remaining			(53,249)	½
			946,751	
Notional tax @ 20%			189,350	½
Effective rate 189,350/1,000,000 x 100%			18.935%	½
Actual rate 18.935% x 30%			5.681%	½
Tax on 10 Year values:				
Share investment portfolio:				
410,000 x 5.681% x (40 – 27*)/40		7,570		2
Other chargeable assets**:				
(630,000 – 410,000) x 5.681%		12,498		1
			20,068	
*Complete quarters 17 February 2012 – 20 November 2018 = 27				
**No reduction for these assets as they have been purchased using original trust funds				
Total marks for part 1				(13)

2) The Pip Life Interest Trust is an interest in possession trust. This means that on creation of the trust the equitable (or beneficial) ownership of the trust property vested immediately

in Imran's children (1/2) who are treated as owning the underlying assets and any income arising thereon (1/2).

The Grape Discretionary Trust is different. As is it a discretionary trust the equitable (or beneficial) ownership is held in abeyance by the trustees (1/2). The beneficiaries have no present right to either the income or capital of the trust until the trustees use their discretion in their favour (1/2).

Total marks for part 2 (2)

Total marks for question 14 (15)

15. Email

To: Tax.Partner@taxfirm.co.uk
From: Tax.Assistant@taxfirm.co.uk
Date: 2 May 2022

Subject: Estate of Julian Jones

Dear Tax Partner,

I have prepared some calculations and notes as follows:

Format mark (1)

1) Calculation of IHT on estate before and after claims for relief:

	£	£	
IHT on estate before any reliefs:			
Chargeable estate		549,000	
Nil rate band		(325,000)	½
Taxable estate		224,000	
IHT @ 40%		£89,600	½
Post-mortem relief on share sales:			
5 September 2021 - 12,000 Strategy plc shares			
Gross proceeds	12,000		
Probate value: 90,000 x 12,000/18,000	(60,000)		½
Loss		(48,000)	
N.B. no relief for costs of sale			½
19 April 2022 - 8,000 Bank plc shares			
Gross proceeds	24,000		
Probate value: 25,000 x 8,000/10,000	(20,000)		½
Profit		4,000	
27 May 2022 - 12,000 Invest Ltd shares Unquoted therefore no relief available			½
30 August 2022 - 6,000 Units in Strike Authorised Unit Trust More than 12 months since Julian's death = no relief			½
Aggregated loss		(44,000)	
Restriction for shares purchased by Executors:			
12 October 2021 - 1,000 shares in Ace plc			
Purchase cost	3,000		
Restriction: 3,000 / (12,000 + 24,000) x 44,000 =		3,667	½
31 July 2022 - 500 shares in Money plc No restriction as more than 2 months after sale of Bank plc shares			½

s.179 IHTA 1984 Loss		£(40,333)	
IHT payable on estate after post-mortem relief:			
Previous total estate after NRB	224,000		
Less s.179 IHTA 1984 loss	(40,333)		½
Taxable		183,667	
IHT @ 40%		£73,467	½
Therefore repayment = 89,600 – 73,467		£(16,133)	½
Total marks for part 1 (including format mark)			(7)

2) Holding the IHT repayment on behalf of the client

As the tax repayment is more than £10,000 (1/2) and is expected to be held by the firm for five weeks, which is more than 30 days (1/2) it should be paid into a separate interest-bearing account (1/2) which is designated as belonging to the Executors of Julian Jones (1/2).

In order to withdraw the funds, Mario (acting as Executor of the estate) (1/2) will need to authorise this in writing (1/2).

Total marks for part 2 (3)

3) Issues around the collection, use and retention of data

Compliance with our obligations under GDPR means that as tax practitioners we must have a valid lawful basis to process personal data (1/2) and ensure that all clients consent to the firm having their personal data (1/2). Mario accidentally sending us the emails containing his friends' contact details does not give us a valid lawful basis on which to process that data (1/2) and nor does it provide consent as the data is not Mario's own personal data and it has been provided accidentally (1/2).

As data controllers and processors (1/2) we need to comply with the seven legal principles (1/2).

Of particular relevance to this situation are the following principles which seek to ensure that personal data is:

- Fairly, lawfully, and transparently processed – it is not fair to process data without someone's knowledge (1/2)
- Not kept for longer than is necessary – if we contact the friends regularly, we will be holding the data for a long time (1/2)
- Held securely and with integrity and confidentiality – if we use the data for our own advantage or pass the data on to other contacts, we will not be holding the data securely, with integrity or confidentially (1)

It is therefore recommended that we remove the data from our systems with immediate effect and contact Mario to inform him of his mistake and confirm that the data has been deleted (1)

Max marks for part 3 (5)

Regards,

Tax Assistant

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

16. 1)

	£	£	£	
	NS	S	D	
2020/21:				
Rental income from office block:				
£3,400 x 4	13,600			½
Rental income from Lilac Cottage:				
£2,750 x 7	19,250			½
Expenses for Lilac Cottage*	(1,500)			½
Choc Ltd dividends**:				
3,500 x £28.50			99,750	½
Bank interest**		3,420		
Salary	4,200			
Less deduction for IHT loan:				
£160,000 x 6% x 8/12	(6,400)			½
Total	29,150	3,420	99,750	
Tax @ 20% / 20% / 7.5%	5,830	684	7,481	1½
Less PAYE	(840)			½
Income Tax payable for year	13,155			
*Only expense for roof repair deductible against income, new bathroom is enhancement expenditure				½
** No apportionment for dividends or bank interest – receipts basis				½
2021/22:		S	D	
Bank interest		3,420		
Choc Ltd dividends:				
3,500 x £14.25			49,875	½
Less deduction for IHT loan:				
£160,000 x 6% x 4/12***		(3,200)		½
Total		220	49,875	
Tax @ 20% / 7.5%		44	3,741	1
Income Tax payable for year	3,785			
***Relief only available for first 12 months of loan				½
Total marks for part 1				(8)

2)

Gloria – 2020/21:				
Specific legatee – receives legacy of office block, therefore entitled to all income arising from office block in year it arises:				½
	Net	Tax	Gross	
	£	£	£	
Estate income	10,880	2,720	13,600	½
Josh/Bex 2021/22:				

Residual legatees – each entitled to half of the residual income arising from the estate less expenses. Assessed at end of administration period 2021/22.				½
	£	£	£	
	NS	S	D	
Income 2020/21	29,150	3,420	99,750	½
Less specific legacy	(13,600)			½
Income 2021/22		220	49,875	½
	15,550	3,640	149,625	
Deduct tax:				
20% / 20% / 7.5%	(3,110)	(728)	(11,222)	1½
Deduct expenses:				
Remainder of IHT loan interest: £160,000 x 6% x 5/12			(4,000)	½
Estate management			(2,600)	½
Distributable income	12,440	2,912	131,803	
R185 (Estate income) Josh/Bex:				
	NS	S	D	
Net	6,220	1,456	65,901	
Tax	1,555	364	5,343	
Gross	7,775	1,820	71,244	
	½	½	½	
Total marks for part 2				(7)

3)

	£	£	
Capital Gains Tax 2020/21:			
5 October 2020 – distribution of office block to Gloria: Distribution to beneficiary not treated as disposal for CGT			1
5 January 2021 – disposal of Lilac Cottage			
Sale proceeds		645,000	
Less:			
Probate value	550,000		½
Costs of sale	4,000		½
New bathroom (enhancement expenditure)	5,000		½
SP 2/04*	2,604		½
		(561,604)	
Chargeable gain		83,396	
Annual Exempt amount (year of death)		(12,300)	½
Taxable gain		71,096	
CGT @ 28%		19,907	½
Capital Gains Tax 2021/22:			
*SP 2/04 - Gross value of estate	1,690,000		
8,000 x 550,000/1,690,000	2,604		

Choc Ltd shares distributed as part of residue not treated as disposal for CGT			1
Total marks for part 3			(5)

Total marks for question 16 (20)