



# **November 2024 Examination**

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## **PAPER 5**

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### **Inheritance Tax, Trusts & Estates**

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Part I Suggested Answers

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1. The trustees of the Flemming Life Interest Trust are eligible to claim Business Asset Disposal Relief (BADR) on their disposal of shares in Aromas Ltd (1/2) because:
  - Sacha owns more than 5% of the shares in Aromas Ltd which is a trading company (1/2) so it is her personal trading company (1/2). The trustees themselves are not required to own a minimum shareholding (1/2).
  - Sacha has also been an officer of Aromas Ltd for at least two years up to the date of sale of the shares by the trustees (1/2).
  - Sacha has also had a life interest in the trust for the two-year period above and her interest is not fixed (1/2).

The claim is subject to Sacha making a joint claim with the trustees as it is her lifetime limit that will be reduced by the claim (1/2).

**Total** **Max (3)**

2. As Mary's death was under 2 years ago, a deed of variation can be considered (1/2).

IHT elections under s.142 IHTA 1984

It is not possible to include an IHT election under s.142 IHTA 1984 where variations are made for consideration.

1. An IHT election under s.142 IHTA 1984 cannot be made as cash consideration, i.e., £18,000 would be received in exchange for the painting (1/2). Felicity would therefore be making a PET of £5,000 (1/2) less annual exemption of £3,000 (or £6,000 if she had made no gifts in the prior tax year) (1/2).
2. Although assets would be received in exchange for the painting, if the swap was made by Felicity and Samuel each making a deed of variation in favour of the other, this is allowable consideration as it consists of assets within the same estate (1/2) and so IHT elections should be made to avoid a transfer of value of £3,000 arising from Felicity to Samuel (1/2).
3. An IHT election under s.142 IHTA 1984 would be available as there is no consideration received, and Felicity should make the election in order to avoid making a PET to Samuel of £23,000 less annual exemption(s) (1/2).

CGT elections under s.62 TCGA 1992

It would be possible for Felicity to make a CGT election under s.62 TCGA 1992 in any of the three scenarios as there is no restriction on receiving consideration in the form of money or money's worth in exchange as there is for IHT purposes. If an election were made the painting would pass to Samuel for £18,000 (1/2)

Without the s.62 TCGA 1992 election the disposal would be treated as being made not at arms-length as Felicity receives less than its full market value in return. The market value rule would therefore apply deeming proceeds to be £23,000 (1/2) and giving a net gain of £2,000 after deducting the £3,000 annual exempt amount. The gain is chargeable at Felicity's marginal rate of CGT of either 10% or 20% (1/2). Samuel would then receive the painting with the higher base cost of £23,000 and it may be considered appropriate to make the election given the small gain to allow Samuel to benefit from the higher base cost (1/2).

**Total** **Max (4)**

- 3.

	<b>NS</b>	<b>Interest</b>	<b>Dividends</b>	
	<b>£</b>	<b>£</b>	<b>£</b>	
Rental income (£1,500 x 7)	10,500			1/2
Bank interest *		3,000		
Dividends			4,000	
Less interest paid on loan for IHT:				
£30,000 x 8% x 5/12	(1,000)			1
Totals	9,500	3,000	4,000	

Income tax @ 20%/20%/8.75%	<u>1,900</u>	<u>600</u>	<u>350</u>	<b>1</b>
Total tax payable for 2023/24			<u>2,850</u>	
* ISA interest remains exempt for 3 years after death/to end of administration period, whichever happens first				<b>½</b>
<b>Total</b>				<b>(3)</b>

4. Your firm should inform the trustees of the error as soon as they identify it (1/2) and request authority to disclose the error to HMRC (1/2).

As the underpaid tax is not trivial (1/2), if the trustees do not immediately authorise a disclosure of the error to HMRC, your firm should then verbally set out to the trustees the consequences of not making such a disclosure (1/2).

If the trustees still do not authorise the disclosure, the member should provide them with written advice of the consequences of non-disclosure (1/2).

Finally, if the trustees do not authorise the disclosure after written advice on the consequences has been provided, the member should cease to act for the client (1/2) and consider whether a report should be made to the MLRO/NCA (1/2).

**Total** **Max (3)**

- 5.

		<b>£</b>	
Market value of gift (50 x £15,000)		750,000	½
APR @ 100%* x (50 x £7,000)		<u>(350,000)</u>	½
Chargeable transfer		400,000	
Nil rate band in 2023/24	325,000		½
Settlor's cumulative total	<u>(50,000)</u>		½
		<u>(275,000)</u>	
Taxable transfer		125,000	
IHT @ 20%		<u>25,000</u>	½

\* APR at 100% as Farm Business Tenancy commenced after 1 September 1995 and has more than 2 years left to run. ½

**Total** **(3)**

6. The Pre-Owned Asset Tax (POAT) rules would not apply to Camille's scenario (1/2) as a gift to a spouse is excluded from these rules (1/2).

The POAT rules would apply to Rita's gift as she will continue to benefit from the cash that she gave away by enjoying the artwork in her own home (1/2). Assuming this is Rita's only POAT charge, to mitigate the charge they should choose the painting rather than the sculpture, as the POAT charge would then be under the de-minimis amount of £5,000 and therefore not subject to Income Tax (1/2) i.e., £180,000 x official rate of interest 2.25% = £4,050 (1/2).

The POAT rules would apply to Antony's father as he would continue to benefit from the cash by using the motorboat (1/2). To mitigate the charge, Antony could wait seven years from the gift of the cash before either purchasing the motorboat or letting his father use it (1/2) as this would then be an excluded transaction not subject to Income Tax (1/2).

**Total** **(4)**

7. For Geoff's estate a form IHT 400 needs to be submitted (1/2). This is because his estate contained a Gift with Reservation of Benefit (GWROB) and so it cannot qualify as a low value excepted estate (1/2), the value is below the IHT threshold and he was UK domiciled, so it cannot qualify as an exempt estate (1/2) or a non-domicile estate (1/2).

A form IHT 400 needs to be completed for Diego's estate (1/2). This is because although he is non-UK domiciled, and his UK assets are valued at under £150,000 (1/2), his estate comprised a UK residential property (1/2).

**Total** **Max (3)**

8. IHT payable:

	£	
Gift to trust	485,000	
Annual exemption 2023/24	(3,000)	1/2
Annual exemption 2022/23	<u>(3,000)</u>	
Chargeable transfer	479,000	
Nil rate band in 2023/24	325,000	1/2
Less cumulative total	<u>          -</u>	
Taxable transfer	<u>(325,000)</u>	
	154,000	
IHT @ 20/80	<u>38,500</u>	1
Gross chargeable lifetime transfer (479,000 + 38,500)	517,500	1/2
Initial value of trust's relevant property	485,000	1/2
<b>Total</b>		<b>(3)</b>

9. As Alys emigrated within 6 years of receiving the portfolio on which the gift relief claim was made (1/2), the deferred gain of £130,000 would become chargeable in 2023/24 subject to any relief or exemption e.g. annual exempt amount (1/2) and the CGT is payable by 31 January 2025 (1/2).

Alys, as donee, is primarily responsible for paying this tax (1/2), however if she does not pay it by 31 January 2026 (1/2), HMRC will ask the trustees of the Cowboy Discretionary Trust, as donor, to pay the outstanding tax liability as calculated (1/2).

**Total** **(3)**

10. This specific legacy would fail if:

- Ronald no longer owned the ring at the time of his death (i.e., by **ademption**) (1/2)
- Alan (or his spouse or civil partner) had **witnessed** Ronald's Will (1/2)
- Alan refuses the ring (i.e., by **disclaimer**) (1/2)
- Alan **forfeits** the ring (for example if he assisted in the unlawful killing of Ronald) (1/2)
- Alan dies before Ronald (1/2)

**Total** **Max (2)**

11. IHT payable as a result of Jill's death:

		£	
Death estate		740,000	
Nil rate band in 2023/24	325,000		
Less cumulative total	<u>-</u>		
		<u>(325,000)</u>	1/2
Taxable estate		<u>415,000</u>	
IHT @ 40%		166,000	1/2
Double tax relief, the lower of:			
Utopian tax	66,500		
UK IHT: 166,000 / 740,000 x 190,000	42,622		1/2
DTR available		<u>(42,622)</u>	1/2
IHT payable		<u>123,378</u>	
<b>Total</b>			<b>(2)</b>

12. CGT payable by the trustees for 2023/24:

		£		£	
York apartment:					
Proceeds		350,000			
Base cost (210,000 – 40,000)		<u>170,000</u>			1/2
Capital Gain*			180,000		
*No Private Residence Relief available as gain held over Under s.260 TCGA 1992 on entry into the trust					1/2
Manchester house:					
Proceeds		495,000			
Base cost		<u>375,000</u>			
Capital Gain		120,000			1/2
Private Residence Relief:		<u>Years</u>			
Actual occupation: 1.5 + 1.5 + 1.5 years		4.5			1
Deemed occupation: July 2016 – July 2018		<u>2</u>			1/2
Total qualifying period		6.5			
Non qualifying: January 2020 – July 2022 **		<u>2.5</u>			1/2
Total ownership period		<u>9</u>			
PRR: 6.5/9 x 120,000		<u>(86,667)</u>			1/2
**not reoccupied by same life tenant			<u>33,333</u>		
			<u>213,333</u>		
<b>Total</b>					<b>(4)</b>

13. Maurice's income tax liability for 2023/24:

	£	
Net trading profits	8,900	
Gross annuity (6,000 x 100/80)	<u>7,500</u>	1/2
	16,400	
Less Personal Allowance	<u>(12,570)</u>	1/2
Taxable income	<u>3,830</u>	
Income tax @ 20%	766	1/2
Less credit of tax on annuity (7,500 – 6,000)	<u>(1,500)</u>	1/2
Tax repayable to Maurice by HMRC	<u>(734)</u>	1/2
The repayment must be repaid to the trustees of the Alcott Trust		1/2
<b>Total</b>		<b>(3)</b>



## **November 2024 Examination**

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#### Part II Suggested Answers

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

14.

- 1) On Rod's remarriage his life interest was revoked. Whilst he was unmarried, the trust was a life-interest trust subject to the basic rates of income tax (1/2), but after his remarriage it became a discretionary trust subject to the trust rates of income tax (1/2). For 2022/23 it was a mixed trust i.e., it was partly taxed at the basic rate of income tax and partly taxed at the trust rate of income tax. (1/2).

	£	£
<b>Tax Liability for 2022/23</b>		
	SI	DI
Dividends		15,000
Interest Income	12,000	
Less: income subjected to IIP:		
(15,000 * 9/12)	(9,000)	1/2
(12,000 * 9/12)		(11,250) 1/2
Total Income in discretionary fund	3,000	3,750
Less: Expenses (£1,500 * 3/12 * 100/91.25) – Note 1		(410) 1/2
Income liable to rates applicable to trusts	<u>£3,000</u>	<u>£3,340</u>

<b>Tax</b>		
£1,000 @ 20%		200 1/2
£2,000 @ 45%		900 1/2
£410 @ 8.75%		35 1/2
£3,340 @ 39.35%		1,314 1/2
Add tax on income subject to IIP:		
£9,000 @ 20%		1,800 1/2
£11,250 @ 8.75%		984 1/2
<b>Income Tax Due</b>		<u><b>5,233</b></u>
Less paid on account		(3,560) 1/2
<b>Balancing payment Due</b>		<u><b>£1,673</b></u>

	£	£
<b>Tax Liability for 2023/24</b>		
	SI	DI
Dividends		40,000
Interest Income	10,000	
Total Income in discretionary fund	10,000	40,000
Less: Expenses (£1,500 * 100/91.25) – Note 1		(1,643) 1/2
Income liable to rates applicable to trusts	<u><b>£10,000</b></u>	<u><b>£38,357</b></u>

<b>Tax</b>		
£1,000 @ 20%		200 1/2
£9,000 @ 45%		4,050 1/2
£1,643 @ 8.75%		143 1/2
£38,357 @ 39.35%		15,093 1/2
<b>Income Tax Due</b>		<u><b>£19,486</b></u>

Note 1: TME's are deducted for income tax purposes from dividends in priority to savings and non-savings income and only from discretionary income (1/2).

	£
<b>Capital Gains Tax Liability for 2023/24</b>	
Proceeds	32,000
Cost	(24,000)
	<u>8,000</u> 1/2
Less: Annual Exempt Amount	(3,000) 1/2
Taxable Gain	<u>£5,000</u>

Capital Gains Tax @ 20% **£1,000** 1/2  
Max (10)



- 2) The penalty for registering over 6 months late on the Trust Register is either 5% of the tax liability for 2019/20, or £300 whichever is greater (1/2). However, penalties are not automatic and can be waived by HMRC if they are satisfied that the trustees took “reasonable steps to comply with the regulations”.

The 2022/23 tax return was due to HMRC by 31 January 2024. An initial penalty of £100 will apply as the return is late (1/2), daily penalties of £10 per day for 90 days i.e. £900 will also apply as the return is more than 3 months late (1/2), finally a penalty of the greater of £300 and 5% of the tax due (£5,233 x 5% = £261) will also apply as the return is more than 6 months but less than 12 months late (1/2). Total penalties for late submission are therefore £1,300 (1/2).

The balancing payment for 2022/23 was due 31 January 2024. Late payment penalties will apply of 5% on each of 30 days after the due date being 2 March 2024 (1/2), and 6 months after the due date being 31 July 2024 (1/2), giving a total late payment penalty of 10% of the tax due i.e., £167. (1/2)

The trustees can appeal against any late filing penalties, late payment penalties or the late registration penalty if they believe they have a “reasonable excuse” for the delay (1/2).

HMRC consider a “reasonable excuse” to be an unexpected or unusual event that is either unforeseeable or beyond a person’s control (1/2).

The trustees are liable for the penalties on behalf of the trust (1/2), however, as it is a duty of the trustees to register the trust with HMRC and to submit the trust self-assessment returns on time (1/2), the beneficiaries are able to hold the trustees personally liable for the loss to the trust as a result of their inaction (1/2).

*Credit will be given for explanation of any circumstances that may or may not be deemed a “reasonable excuse”.*

Max (5)

Total (15)

15.

- 1) Business Property Relief (BPR) is available on “relevant business property”. Shares in an unlisted trading company qualify as “relevant business property” (1/2). There is no minimum shareholding to qualify for the relief (1/2).

#### Death Estate

In general, assets must have been held for two years prior to death to qualify for the relief (1/2). Rex’s 25% shareholding subscribed for in April 2018 therefore qualified (1/2)

However, although Rex hadn’t owned the 50% shareholding inherited from his wife in April 2022 for two years on his subsequent death (1/2), under s.108 IHTA 1984, the ownership period of spouses or civil partners can be aggregated (1/2) if the first transfer is on a death (1/2). This 50% shareholding also therefore qualified for relief on Rex’s death (1/2)

(4)

- 2) Lifetime gift to Jack

At the time of the transfer Rex held, “relevant business property” (1/2) throughout the period of two years prior to the gift (1/2). As Rex purchased the shares in April 2018 and gifted them to Jack in May 2020, this two-year ownership condition is satisfied (1/2)

Additional conditions also apply to lifetime gifts chargeable to Inheritance Tax on death e.g., failed Potentially Exempt Transfers (PETs) (1/2).

Jack had retained the 25% shareholding received from Rex in May 2020 (1/2), and the shares remained unlisted (1/2). They therefore qualified for BPR on Rex's death. (1/2)

3) Transfer to Discretionary Trust (3)

The 25% shareholding (1/2)\* held since May 2020 qualified for BPR on the transfer as the had been held for two years. (1/2)

However, although Rex hadn't owned the 75% shareholding inherited from Rex in May 2023 for two years prior to the transfer (1/2), under s.109 IHTA 1984, BPR is available where successive transfers have occurred within a two-year period if the first transfer qualified for BPR, which it did (1/2) and if either transfer was made on death, which the first transfer from Rex to Jack was (1/2). This 75% shareholding also therefore qualified for relief on transfer into the trust (1/2).

\* this 1/2 mark is for considering the two parts of the shareholding separately.

(3)

Total (10)

16.

- 1) Lacy's estate is a separate client to Lacy individually (1/2), therefore you will need to complete client take on procedures before continuing to act. These could include:
- Anti money-laundering identification checks on the executors of the estate
  - Assess the risk for the firm of taking on the new client
  - Client engagement letters setting out the terms under which you act
  - Fee Agreements with the executors for the work you are completing
- (1/2 mark each – credit will be given for any other reasonable procedures).

Max (2)

2)

	£	£	
<b>IHT on Lacy's death</b>			
Death estate (Note 1)		2,150,000	
Spouse exemption		(475,000)	1/2
Nil rate band	325,000		1/2
Less chargeable transfers in previous 7 years	(150,000)		1/2
Residence Nil rate band (Note 2)	<u>100,000</u>		1/2
		<u>(275,000)</u>	
		1,400,000	
Less: Charitable Donation (Note 3)		<u>(160,000)</u>	1/2
		<u>£1,240,000</u>	
IHT @ 36% (Note 4)		£446,400	1

**Note 1: Death Estate**

	£		
Main Residence	920,000		
Listed Share Portfolio	475,000		
Rental Property Portfolio	660,250	1*	
Cash	82,000		
Chattels & Personal Affects	15,000		
Less: Funeral Expenses	<u>(2,250)</u>	1/2	
	<u>2,150,000</u>		

**\* This mark is for the inclusion of all assets in the Estate calculation with no reliefs available.**

**Note 2:** The residence nil-rate band is available as Lacy's main residence is being passed to her lineal descendants (1/2). As Lacy's Estate is over £2million, the RNRB is tapered as follows:

$$\text{Taper amount} - (2,150,000 - 2,000,000) \times 50\% = 75,000 \text{ (1)}$$

$$\text{RNRB available} - 175,000 - 75,000 = 100,000 \text{ (1/2)}$$

**Note 3:** Whilst a donation to a UK registered charity is exempt for IHT purposes, a gift to a non-UK registered charity remains a chargeable transfer in the death estate, therefore only the donation to the cat rescue is deductible in calculating IHT (1/2).

**Note 4:**

	£	£	
<b>Calculation of baseline amount</b>			
Death estate		2,150,000	
Less: Spouse Exemption		(475,000)	1/2
Less: Charity Legacy – not deducted		<u>1,675,000</u>	1/2
Less: Nil rate band (325,000 – 150,000)		<u>(175,000)</u>	1/2
<b>Baseline Amount</b>		<u>1,500,000</u>	1/2
Baseline amount x 10%		150,000	1/2

The residence nil rate band is not considered in calculating the baseline amount. 1/2

As the amount of the exempt UK charitable legacy (£160,000) is greater than 10% of the baseline amount, the lower rate of 36% is used to calculate the IHT due (1/2).

(11)

- 3) The primary roles of an executor are to (1/2 each – Max 2):
- Obtain probate or letters of administration
  - Ascertain the assets and liabilities of an estate
  - Collect the assets of an estate, recover debts, and preserve the assets
  - Pay the expenses, debts, and liabilities of the estate where possible
  - Distribute the estate in line with the Will

For Bob to renounce his appointment, he must do this in writing (1/2) before the executors have obtained grant of probate (1/2). If Bob has begun to deal with the affairs of the estate already, or if probate has been granted, he is no longer able to renounce his appointment (1/2).

Max (3)

Total (16)

17.

- 1) The Rachel Berry Grandchildren's Trust was set up as an accumulation and maintenance trust before 22 March 2006 (1/2).

As the beneficiaries of the Trust are entitled to the capital of the Trust aged 25 (1/2), the Trust will qualify as an 'Aged 18-25' trust (1/2).

There are no exit charges when assets leave the Trust up to the beneficiary attaining the age of 18 years (1/2) therefore the distribution to Isabella will not be subject to an exit charge as she is under the age of 18 on the distribution date (1/2).

After the age of 18, exit charges are levied on any capital distributions from the Trust (1/2)

As the distribution to Harry occurred in the first quarter following his 18<sup>th</sup> Birthday (1/2) no exit charge applies as no complete quarters have elapsed (1/2)

The distribution to Darcey will be subject to an exit charge (1/2) calculated as follows:

	£	£	
Initial value of trust @ 9/1/2006		1,000,000	1
NRB at date of exit	325,000		
Less: Chargeable Transfers in previous 7 years	(NIL)		
		<u>(325,000)</u>	1/2
		675,000	
Notional IHT		135,000	1/2
Effective Rate (135,000/1,000,000)		13.5%	1/2
Actual Rate (x 30% x 23/40) - (Working)		2.33%	1
Exit charge (8,000 x 2.33%)		£186	1/2

Working

n = 5 August 2018 to 1 August 2024 = 23 complete quarters (1)

Max (9)

- 2) Under the principles in Crowe v Appleby (1/2), where a beneficiary of an Accumulation and Maintenance Trust becomes entitled to an undivided share of land (1/2) there is no disposal until such time as all of the beneficiaries become entitled (1/2).

No CGT liability will therefore arise on the attainment of aged 25 for any of the beneficiaries until the youngest beneficiary turns 25 (1/2). In this case, the full CGT Liability will become payable by the Trust in January 2031 when Isabella turns 25 (1/2). At this point, only Isabella's share of the property will be subject to an exit charge (1/2), and therefore only her share of the gain will be eligible to be deferred under s. 260 TCGA 1992 (1/2). The remaining gain will be crystallised immediately, and no holdover relief will be available (1/2).

(4)

- 3) To be able to holdover the gain on the distribution of the property, the remaining interest must be distributed to the grandchildren at the same time and before the next grandchild reaches age 25 (1/2). The full distribution will then be subject to an exit charge and the gain arising can then be held over under s.260 TCGA 1992 (1/2). The trustees therefore have until Darcey's 25<sup>th</sup> Birthday on 5 August 2025 to distribute the remaining property to Darcey, Harry, and Isabella (1/2). Jake's previously vested interest will still be subject to CGT. (1/2)

If the trust deed allows for express advancement of the Trust Capital, the land could be advanced to the children before they reach 25 (1/2). Under s32 TA 1925, pre-2014 trusts only enable trustees to advance half of the capital share to each beneficiary but if the trust contains additional assets, there may be an option to advance the value of the land (1/2).

*Scots Law:* For advancement before the age of 25 there must be an express clause in the trust deed (1).

If the above is not possible, the Trustees could look to vary the Trust to enable advancement of the land (1/2). This could only be done via a court application (1/2) as *Saunders v Vautier* does not apply to this situation (1/2).

*Credit will be given where these principals are described in more detail, but this is not required.*

Max (4)