Association of Taxation Technicians

Examination

May 2007

PAPER 4

IHT, TRUSTS & ESTATES

ANSWERS
(without marking guide)

Association of Taxation Technicians IHT Examination –
Short form questions

Answer 1

a) Taking one year with another, the transfer was made out of income; and
b) It leaves the transferor with sufficient income to maintain his usual standard of living
c) It is made as part of the normal expenditure of the transferor

Example : insurance premium

Answer 2

The three conditions that must be satisfied are that:

i) one or more of the beneficiaries will become entitled to the capital or the income upon attaining the age of 25 years at the latest;
ii) meanwhile no interest in possession subsists and the income is either accumulated or distributed for the maintenance, education or other benefit of one or more of the beneficiaries; and
iii) not more than 25 years have elapsed since the settlement was made, or all the beneficiaries have a common grandparent.

Answer 3

(i) Registered shares are situated where the register is kept. This is generally in the country of incorporation. Bearer shares are situated where the share certificate is at the time of transfer.

(ii) Bank accounts are situated at the branch where the account is kept

Answer 4

- Certainty of words and intention (i.e. there must be a clear indication that the settlor intends to create a trust).
- Certainty of subject matter (i.e. the property that is the subject of the trust must be clear).
- Certainty of objects (i.e. the beneficiaries of the trust must be clearly identifiable).

Answer 5

- The deceased can choose the personal representatives
- Executors can act before grant of probate
- Guardians of infant children can be appointed
- Executors can be given extended powers
- A will can contain special requirements
- The estate can be distributed fairly, as the deceased would have wished

Scots Law

Answer 5

The surviving spouse has a right to the deceased's dwelling house up to a statutory maximum of £130,000 provided the deceased was ordinarily resident there at the date of death.
If the value of the house exceeds £130,000, the surviving spouse is entitled to a cash sum instead.
In addition, the surviving spouse is entitled to the contents of the dwelling house, up to a statutory maximum of £22,000.
The contents for these purposes do not include items used for business purposes.

Answer 6

		£	£	
MV of 350 Cyberspace plc shares on 4/2/07		24,325		
Less cost/MV of the shares into trust 2/4/04 £2.68 x 350		938		
Unindexed gain		23,387		
Less indexation		Nil		
Untapered gain		23,387		
Taper relief for non-business asset	3 years and no bonus year = 5%			
Chargeable gain	95%	22,217		
Less trustees annual exemption	06/07	(4,400)		
Chargeable gain		17,817		
Tax due	40%		7,126.80	

Answer 7

The shares are not a business asset and so do not qualify for holdover relief under s165. However, a transfer out of an accumulation and maintenance trust does qualify for holdover relief under s260, provided that the trustees and the beneficiary make a joint claim.

If a claim is made, the full untapered gain of £23,387 is heldover, thus resulting in the loss of taper relief and the annual exemption. (1 mark)

Answer 8

IHT is not due on the transfer out of an A & M trust, as:

- this is before the new rules and
- the beneficiary is entitled to the capital at 18 years.

Answer 9:

	£	£	Tax due	£	Marks
Rents from a furnished property in London	5,000				
Less furnished letting 10% deduction	(500)				
		4,500	At 22%	990.00	
Bank interest Gross at 100/80		655	At 20%	131.00	
Dividends Gross at 100/90		753	At 10%	75.30	
IT liability				1196.30	
Less taxed at source			Bank	-131.00	
			Divs	-75.30	
IT payable				990.00	

Answer 10

- Return of the disposition made to HMRC on form IHT 100
- By the end of August 2007 (12 months after the end of the month in which the transfer takes place.)

Answer 11

Calculation 1 The value per share is calculated as:
989 + (¼ × (993 - 989) = 990p.

Calculation 2 However, if it produces a lower valuation, the halfway price between the highest and lowest sales of the day is taken – namely:-

(970 + 996)/2 = 983p.

The value of the shares for IHT purposes is £117,960
(i.e.12,000 shares × £9.83).

Answer 12

The gift of the care is a PET. However it is also caught by the gift with reservation rules as Mary is continuing to use it. The pre-owned asset rules therefore cannot apply and so there is no income tax charge.

Answer 13

Notional tax:	285,000 – 219,000 =	66,000 x 0%	nil
	173,600 – 66,000 =	107,600 x 20%	<u>21,520</u>
			<u>21,520</u>

Tax rate on notional transfer:

$$\frac{21{,}520}{173{,}600} \times 100 = 12.396\%$$

Completed quarters: 9 years + 1 quarter (ie 37 quarters out of 40 quarters in 10 years)

Modified tax rate:

$$\frac{37}{40} \times 30\% \times 12.396 = 3.440\%$$

Tax payable by beneficiary:

3.440 % x £19,000 = **<u>£653</u>**

Answer 14

(i) A trustee can charge for his services, providing those charges are reasonable.

(ii) England and Wales –The Trustees must generally act unanimously, unless the Trust deed permits otherwise.

Scotland – The Trustees may act by simple majority unless the deed provides differently

Answer 15

- Obtain satisfactory evidence of the new client's identity. In this case, the executor(s).
- Maintain records of all transactions they carry out for the client.

Answer 16

a) Not release information to the third party which can be said to be confidential without first obtaining the client's consent.

b) The member should require as a term of the engagement that the client must seek the member's consent before releasing information produced by the member to third parties.

c) Before consenting to the release of documents, the member may request that the third party undertake that the member will be held harmless from liability.

d) If no such undertaking is obtained, the member should obtain confirmation that no responsibility is accepted.

Long Form Question 1

1) Calculations of the lifetime tax due

		£	
1	**22/01/2000**		
		10,000	
		(3,000)	99/00
		(3,000)	98/99
		4,000	

PET therefore no lifetime tax

2	**21/04/2002**		
		225,000	
		(3,000)	2002/03
		(3,000)	2001/02
		219,000	

CLT therefore tax would be due
However Nil Band of £250,000 available to cover = nil tax

3	**09/03/2003**		
		95,000	
		0	(AEs used for 2002/03)
		95,000	

PET therefore no tax due

4 **19/03/2004**

230,000				
(3,000)	2003/04			
0	2002/03	used		
227,000				
0				
	Nil Band at 2003/04		255,000	
	Less CLT in last 7 yrs		(219,000)	
(36,000)			36,000	
191,000				
CLT therefore tax due at 20%				£38,200

Trustees pay

By 30/09/2004
(6 months after end of month of transfer)

5 **01/03/2007**

	5.000
Marriage exemption	(5,000)
	Nil

2) Calculation of the death tax due on lifetime gifts

£

1 **22/01/2000**

Patsy died on 16/03/07 therefore more than 7 years later

2 **21/04/2002**

225,000	
(6,000)	(02/03 & 01/02)
219,000	

Nil Band at death	285,000	
	-	
	219,000	
	66,000	left

Therefore no additional tax due

3 **09/03/2003**

95,000	
0	AE now used
95,000	
(66,000)	
29,000	Now chargeable

Tax due at 40% =	£11,600
Taper relief for 4-5 years	
40% taper relief	(4,640)
60% chargeable	£6,960

Payable by Nick

Due date 30/09/2007
(6 months after end of month of death)

4 **19/03/2004**

230,000
(3,000)
227,000

	Less Nil band	285,000	
	CLTs in last 7 years	(285,000)	
0		0	
227,000			

Tax due at 40%	90,800
Less taper relief	
Nil as within three years of death	0
Chargeable	90,800
Less lifetime tax paid	(38,200)
	52,600

Payable by trustees

By 30/09/2007
(6 months after end of month of death)

5 **01/03/2007**

	5,000
Marriage exemption	(5,000)
	0

3)

Death Estate	£	£
Shares in Wood Ltd	242,000	
Less BPR 100% as unquoted trading co	(242,000)	
		0
Shop in Sussex	395,000	
Less 50% BPR as L & P used in business	(197,500)	
		197,500
Leasehold flat		232,000
Cash, investments and bank		24,150
Personal possessions and other		1,905
		455,555
Nil band 2006/07	285,000	
Less used	(285,000)	
		0
Chargeable to tax		455,555
Tax at 40%		£182,222

4) The estate will be distributed equally between the three children, Gillian, Nick and Briony. They will therefore each acquire one third.

The distribution may be changed by way of a Deed of Variation.

Conditions:
For no consideration/ no reciprocity

To be submitted to HMRC within 6 months.
Signed by all the beneficiaries affected.
Time limit:
Within 2 years of death

Q2
1)

Tax comp		£	£	£	£	£	
		Non savings	Savings	Dividends	Tax due	Tax paid	
Rental income		10,000				0	
Bank /Building society interest £460 x 100/80			575			115	
Bank interest from investment bank Received gross			352			0	
Divs 2,900 x 100/90							
Divs from trust fund £21,053 x 100/90				23,392		2,339	
Total	34,319	10,000	927	23,392		2,454	
Less trustee management expenses:							
£600 x 100% income related Gross up 100/90				(667)			
Taxable		10,000	927	22,725			
Tax liability							
First £1000 at 22%					220		
Non savings £10,000-1,000 = £9,000 at 40%					3,600		
Savings at 40% 927@ 40%					371		
Divs at 32.5%					7,386		
Tax due on expenses £667 @ 10%					67		
Total liability					**11,644**		
Less tax paid						(2,454)	
Tax payable						**9,190**	

2)

		£	£	
Proceeds for 1,000 shares in May 2006		15,000		
Less cost/MV of the shares into trust £3.01 x 1,000		3,010		
Unindexed gain		11,990		
Less indexation		Nil		
Untapered gain		11,990		
Taper relief for non-business asset	8 years and no bonus year = 30%			
Chargeable gain	70%	8,393		
Less trustees annual exemption	06/07	(4,400)		
Chargeable gain		3,993		
Tax due	40%		1,597	

3)

	£ **Net**	£ **Tax**	£ **Gross**	
Lauren	2,000	1,333	3,333	
Emily	3,000	2,000	5,000	
		3,666		

4)

Filing date	31 January 2008	
Penalties	£100 if submitted after 31 January 2008.	
	£100 if submitted after 31 July 2008 (or six months after the filing date, if later).	
	An amount equal to the tax payable under the return if not submitted within one year of the filing date.	

5)

EMAIL

From An adviser of the firm **To** The Trustees of the Smithy Family 1998 Disc Trust
Date 1 May 2007

Subject Capital and income payments from the trust

Dear Trustees

I am enclosing some details relating to the payment of trust funds to the three beneficiaries of the trust which I think you will find useful when considering how these are paid. They are brief pointers on things to consider and we can advise you further on this and suggest we meet to discuss them.

Capital payments

When the trust makes capital payments of cash from a discretionary trust, there may be an 'exit charge' for IHT purposes.

No income tax consequences.
No capital gains tax consequences unless an asset sold to fund any payments.

For this trust, and the fact that it has been in existence for less than 10 years, the exit charge will be based on the initial value of the property going into the trust at the time it was set up, together with gifts made in the 7 years prior to the trust being set up less the nil rate band - **Payments out of income** This is an income tax matter. The payments will be deemed to be made net of 40% tax, as with the R185s calculated above. The tax portion of the income tax payments will need to be covered by the income tax paid on the income coming into the trust, within the s387 pool. If the tax credit is not covered by the amount in the pool, then an additional tax charge will be due. **Factors to consider** Things to consider when deciding the best method: - Beneficiaries' tax position - Whether personal allowances can create a repayment or save tax - Compare the amount of IHT due vs income tax due on these payments	

Q3

Memo

To Senior Partner

From Tax Assistant

Subject: your meeting with Rodney and Charles (1 mark)

Further to your email, I am writing with some notes for your meeting.

- Farmhouse; the farmhouse should qualify for 100% IHT Agricultural Property Relief. It needs to be of a character appropriate to the property and used for the purposes of the agricultural activity.

- 100% APR should be available on the farmland, providing it is agricultural land or pasture, or any land used in the intensive rearing of livestock or fish.

- As the disused building is not used for the purposes of the farm nor the farm shop business neither APR nor BPR will be available.

- The property that is rented out will not qualify for any Business Property Relief.

- The interest in the farm shop will qualify for 100% BPR as it is an asset used in a partnership business.

- However, the interest in the partnership business itself will not qualify for BPR because the agreement represents a "buy and sell" agreement on which BPR is not available.

- No relief is available on shares in a company which exists wholly or mainly as an investor in land or buildings or a property dealing or developing company.

- In all the above cases, the property must be owned for two years for APR/BPR to be claimed.

2 If the partnership agreement were amended (1 mark) so that instead of the buy and sell arrangement each partner has a cross option agreement so that they had the option to purchase each other's share, then 100% BPR should be available.

Placing an activity, agricultural or business, in the disused building should achieve APR/BPR.

In order to reduce the possible IHT on Rodney's death, he could consider gifting some assets now to Charles to equalize their estates. Such transfers would be classed as PETs and would escape IHT if Rodney survived for seven years. The value of a PET is frozen at the time of the transfer and, provided Rodney survives for at least three years, any IHT due will be reduced by taper relief at the rate of 20% a year. He could also use his annual exemption and last year's if not already used. Small gifts of up to £250 per donee are also exempt as is normal expenditure out of income.

Rodney could also consider taking out a policy of life insurance to cover the IHT liability

3 The consequence of becoming registered civil partners would be that for IHT purposes, Charles would be treated as Rodney's spouse and assets passing to Charles during lifetime or on Rodney's death would be exempt from IHT.
For CGT purposes, transfers between civil partners are treated as occurring as between spouses, so the transaction would take place at no gain no loss.