Association of Taxation Technicians

Examination

November 2007

PAPER 4 – PART II

INHERITANCE TAX, TRUSTS & ESTATES

TIME ALLOWED – 3 HOURS
(for Part I and Part II)

- You are required to answer **all** questions in Part I (printed separately) and Part II.
- The maximum number of marks for each question in Part II is shown in brackets.
- For Part II, start each answer on a new sheet of paper.
- All workings should be shown and made to the nearest month and pound unless the question requires otherwise.
- Marks are specifically allocated for good presentation.

1. Ms Honeychurch is a wealthy lady and a higher rate taxpayer. She is 35 and has no family other than her brother Frederick.

Unfortunately, Ms Honeychurch has a progressive illness and needs some tax advice on the best way to minimise her tax liabilities.

She has already given away some property over the years as follows:

4 September 1998	A gift of £10,000 to her best friend, Valerie.
24 December 2004	10 shares in an unquoted trading company, FWB Ltd, valued at £260,000 to her ex-husband, George. He took over the business and still owns the shares.
7 July 2005	£4,000 to each of her four god-children.
1 April 2006	A transfer of cash of £340,000 into a discretionary trust for her nieces and nephews (lifetime tax of £13,000 was paid by the trustees at the time the settlement was created).

The remainder of her assets are as follows:

1) Her home, valued at £650,000.
2) A holiday home in Ruritania, which is currently worth RUR $180,000. The exchange rate is currently 0.853 Ruritanian dollars to £1 sterling (you are to assume that no tax will be due on this property in Ruritania).
3) £136,500 in investments, bank accounts and cash.
4) £15,300 in personal possessions and chattels.

The holiday home originally cost Ms Honeychurch £70,000 with agent's fees of £3,000 on 9 May 2002.

Assuming that today's date is 7 November 2007 and that the tax rates and allowances for 2006/07 also apply for later years, you are required to:

1) **Calculate the Inheritance Tax that would arise if Ms Honeychurch were to die today.** (8)

Ms Honeychurch feels that she could afford to give away the holiday home in Ruritania without affecting her lifestyle. She would like to know the tax implications of giving this property away to her brother Frederick during her lifetime, in comparison to leaving it to him in her will.

2) (a) **Explain how much, if any, Inheritance Tax and/or Capital Gains Tax would arise in respect of the holiday home in Ruritania, if it passed to Frederick on Ms Honeychurch's death. Support your answer with appropriate calculations.** (2)

(b) **Explain how much, if any, Inheritance Tax and/or Capital Gains Tax would arise in respect of the holiday home in Ruritania, if Ms Honeychurch made a lifetime gift of the property at today's date. Support your answer with appropriate calculations.** (5)

(c) **Explain how your answer to (b) above would differ if Ms Honeychurch should die one year after making the lifetime gift.** (2)

(d) **Ms Honeychurch has also considered giving away the property in Ruritania to Frederick, but continuing to use it for two months every summer. Explain the Inheritance Tax implications of gifting the holiday home in this way.** (3)

Total (20)

2. One of the partners in your firm has received the following letter from a client, Mr Gerald Jones. He is the senior partner in a firm of solicitors in town.

Here is an extract from the letter:

"My brother died recently and, whilst finalising his affairs, I discovered that the administration of the family discretionary trust had not been properly dealt with.

The trust was established on my aunt's death in 1977, and comprised of a flat situated in central London. The trustees of the trust were my parents and on their death about 10 years ago, my brother, sister and I took over as trustees. My brother always dealt with the administration of the trust and my sister and I relied upon him to do so. Following the death of my brother, my sister and I decided to sell the property. No income has ever been distributed from the trust, so there is a fair amount of cash in the bank account.

We sold the property on 1 August 2007 for £450,000, and would like your advice on what tax the trustees will need to set aside.

From my brother's papers, I have been able to piece together the following information.

When the trust was set up the flat was worth £50,000 and the market value as at March 1982 was £70,000. The trust deed states that "any member of the Jones family can live in the property rent free" and, when not occupied by a family member, the trustees should rent the property out. Over the years the occupation and use of the property has been as follows. All family occupation has been rent-free.

10 December 1977 – 31 August 1985 – Lived in by my Uncle.

1 September 1985 – 31 July 1992 – My daughter occupied the property as her home, while she studied at University in London and then when she started work there.

1 August 1992 – 31 August 1996 – Rented out at around £700 per month.

1 September 1996 – 31 October 1999 – Empty. The trustees undertook some refurbishment in August 1998, spending around £25,000 on the property (that doesn't include the VAT, which came to £4,375).

1 November 1999 – 30 April 2004 – My brother occupied the property after his divorce; he had nowhere else to live.

1 May 2004 – 30 June 2007 – Rented out at £1,250 per month.

1 July 2007 – 1 August 2007 – Empty whilst on the market awaiting a purchaser.

What is also worrying my sister and I is that we haven't been able to find any paperwork from HM Revenue & Customs about the trust; no tax reference number, no copies of returns; nothing. I have an awful feeling that no one's ever told HM Revenue & Customs that the Trust exists."

You are required to draft a letter to Mr Jones, dealing with the following points:

1) **Calculate the Capital Gains Tax arising on the disposal of the property and state when payment of the tax is due. You are to assume no changes in rates or annual exemptions from 2006/07.** (10)

2) **Advise Mr Jones of any other tax liabilities that may exist in respect of the trust.** (5)

3) **Advise Mr Jones on what penalties HM Revenue & Customs could seek if he is correct that they have not been notified of the trust's existence, and how you would advise the trustees to deal with HM Revenue & Customs.** (5)

Total (20)

3. In May 1999, Mr Davies set up 'The Davies Family 1999 Discretionary Trust' for his two sons, Adam and Joe.

The trust was set up with 20,000 shares in the Blue Moon Mining Co. The shares were valued at 1.98 New Zealand dollars per share when the exchange rate was 0.3184 New Zealand dollars = £1 sterling. Hold over relief of £2,450 was claimed on the transfer of the shares into the trust. The Blue Moon Mining Co is a quoted trading company. It has not declared a dividend for the last two years.

The trust also holds some quoted shares and a commercial property from which rental income is received. Any rental income is placed on a high rate bank deposit account.

The trust had the following income in 2006/07:

Source of income	Amount received
	£
Rental income – net of expenses	24,286
Bank deposit interest	1,200
Solicitor's client account interest	402
UK Dividends	315

The trustees also incurred expenses of £1,400.

At the start of 2006/07, Adam was eight years old and at boarding school. Joe was 18 years old and taking a gap year out travelling in New Zealand. He arrived back in the UK in July 2006 and spent the summer working at the local supermarket, earning £1,000 in total, before going to university. In order to help repay the debts incurred by Joe during his gap year, on 1 August 2006 the trust sold 2,200 shares in the Blue Moon Mining Co for 5.87 New Zealand dollars per share when the exchange rate was 0.3465 New Zealand dollars = £1. The proceeds received from the sale were given to Joe.

In November 2006, Mr Davies left his job to look after his wife who was very ill. He received employment income of £29,035 up to the date of cessation. He incurred a capital loss of £2,000 on the sale of some shares in December 2006. To fund Adam's school fees for the next term, the trust made a payment of income to Adam amounting to £4,000 (gross) in January 2007.

You are required to:

1) Explain who will be liable for Income Tax on the distribution made to Adam (you are NOT required to calculate the tax). (2)

2) Calculate the Capital Gains Tax due on the sale of the shares. (7)

3) Calculate the Income Tax payable by the trust for 2006/07. (7)

It is now March 2007 and you learn that Mrs Davies has died, but left no will.

From your file you learn that:

(a) The couple jointly own their main residence.

(b) They have a building society account held in joint names.

(c) Mrs Davies owns a house in her own name which is rented out.

4. You are required to make notes in preparation of a full letter to Mr Davies outlining the rules of intestacy. (4)

Total (20)