Association of Taxation Technicians

Examination

November 2007

PAPER 4

INHERITANCE TAX, TRUSTS & ESTATES

ANSWERS (without marks)

IHT AND TRUSTS

1

1 PET becoming chargeable as a result of death within seven years.
£250,000 x 40% = £100,000 less 40% taper relief (gift after four years) = £60,000 IHT payable

2 100% Business Property Relief is available to cover the gift.

3 PET becoming chargeable as a result of death within seven years.
IHT due: £75,000 x 40% = £30,000. Not exempt as not a UK charity.

2.

IHT can be paid in instalments where the shares are:

1 Listed or unquoted shares which gave control of the company
2 Unquoted shares or securities where the Board are satisfied that the tax attributable to the shares cannot be paid in one sum without undue hardship.
3 Unquoted and the IHT is at least 20% of the total tax payable by the executors.
4 Unquoted shares where the value charged to IHT is at least £20,000 and the nominal value is at least 10% of the shares in the company.

3 In order to qualify for the exemption, at the last election a political party must have had either:

- two members elected to the House of Commons or
- one member elected to the House of Commons and the party received at least 150,000 votes.

4 Two examples of excluded property are as follows:

1 Property situated overseas where the owner is not UK domiciled

2 Reversionary interests in trust funds

5

1 Chargeable Lifetime Transfers – the due date is 12 months from the end of the month in which the transfer is made. Therefore 31 August 2007

2 PET becoming chargeable on death – the due date is 12 months from the end of the month in which death occurred – therefore 30 September 2007

3 Return in respect of the estate – the due date is 12 months from the end of the month in which death occurred - therefore 31 March 2008

6 1. CLTs between 6 April and 30 September = 30 April in following year. Therefore, 30/04/07

2. Lifetime gifts, becoming chargeable on death = 6 months after the end of the month of death. Therefore, 31/03/07

3. Tax due on the estate. 6 months after the end of the month of death. Therefore 30/09/07

7 Billy and Bunty own 65% of the shares in the company, so the value of their total shareholding is 1,750 + 1,500 shares = 3,250 shares, being a 65% holding.

The price of each share based on a 65% holding is £75.

The value of Bunty's shareholding is therefore 1,500 x £75 = £112,500.

8

Tax on increase:

$44,800 \times \frac{330,200}{375,000}$ (375,000 – 44,800) = £39,448

Tax on Alan's estate:

£550,000 - £285,000 x 40% =	£106,000
Less Quick Succession Relief (£39,448 x 60%) =	(£23,669)
Tax payable	£ 82,331

9

For IHT purposes, Doris, as life tenant of the trust is treated as owning the capital of the trust. The trust assets will therefore form part of her estate.
Since Doris left her own assets to charity (exempt transfer) and she made no lifetime transfers, the whole of her nil rate band will be set against the trust assets.
The excess of trust assets over the nil rate band will be charged at 40%.
The tax will be payable by the trustees out of the trust capital.
For CGT purposes, there is a disposal of the chargeable assets in the trust on the death of Doris. However, since the disposal was on the death of the life tenant, the gain will be exempt.
Joan will therefore acquire the chargeable assets of the trust at probate value at the date of Doris's death.

10

Jeremy may be subject to an income tax charge under the pre-owned asset rules as cash that he gave to his son was used to purchase the paintings which are now enjoyed by Jeremy. The charge would be calculated by applying the official rate of interest to the value of the assets: 5% x £1,500,000 = £75,000. The charge will be reduced if Jeremy pays rent for the use of the paintings, provided this is under a legal obligation.

11. English

1. Determine the assets and liabilities of the estate
2. Obtain probate or letters of administration
3. Collect in the assets and pay the liabilities of the deceased
4. Deal with HMRC and settle any tax liability
5. Distribute the estate in accordance with the will/rules of intestacy

Scottish

1. Collect in the assets of the estate and pay the liabilities of the deceased

2 Deal with HMRC and settle any tax liability
3 Distribute the estate in accordance with the terms or the will or rules on intestacy

12

1 Inappropriate – this is gambling
2 The charity commission considers this to be inappropriate as there is no guaranteed return
3 Appropriate
4 Appropriate

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

Examples of this are when they pay trust money to the wrong person, or if they make a profit out of their position of trustees without authority.

There are two remedies available to beneficiaries to recover losses suffered:

1 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. Property cannot be recovered from a bona fide purchaser for value who does not have notice that it was in breach of trust.

2 Alternatively, or in addition, the beneficiaries can claim damages from the trustees who are in the first instance personally liable for any loss (or any balance of loss) not recovered through an action above.

14 A resulting trust arises when legal title to the property has been transferred to another owner but the beneficial interest reverts to the settlor, or, if he is dead, to his estate (1 mark).

Examples of a resulting trust:

1 Where an intended trust fails for any reason, the property reverts back or returns to the settlor who provided it.

2 A resulting trust may arise where there has been a breach of trust, but there is no money left over after the purpose has been achieved.

3 A resulting trust may also arise where a person purchases property which is held in someone else's name.

15 Members in practice must ensure that arrangements exist for the **continued existence** of professional indemnity insurance for a period of **not less than six years** after they cease to engage in public practice.

Such professional indemnity insurance shall be on terms satisfying the requirements of the professional indemnity insurance regulations as applied to their firm during the year immediately preceding such cessation.

PART II - ANSWER 1

1)

IHT:

Lifetime gifts:

	£			
04/09/1998	10,000		PET therefore no lifetime tax	)
			Outside 7 years	)
			Therefore no IHT due	)

24/12/2004 PET becoming chargeable

260,000		
-260,000	BPR	As George still owned the shares at Ms H's death
0		

07/07/2005 PETs becoming chargeable

16,000		
-3,000	2005/06	)
-3,000	2004/05	)
10,000		

Covered by Nil rate band of £285,000, therefore no tax due

Nil Band left	285,000	
	-10,000	
	275,000	(mark below)

01/04/2006 CLT to discretionary trust for nieces and nephews

340,000			
0	2005/06		)
0	2004/05	AEs used	)
340,000			
-275,000	Remaining Nil Band (285,000 less 10,000 above)		
65,000			

Tax due at 40%	26,000
Less IHT paid in lifetime	-13,000
Further IHT due on death	13,000

No taper relief is due
as the gift was made less than 3 years before death

Death Estate			£	
Home			650,000	
Holiday home in Ruritania				
	RUR $180,000 Converted to Sterling at 0.853		211,020	
Investments, bank accounts and cash			136,500	)
				)
Personal possessions and chattels			15,300	)
			1,012,820	
	Nil band 2006/07	285,000		)
		-		
	Less used	285,000		)
			0	)
	Chargeable to tax		1,012,820	
	Tax at 40%		405,128	

2) a)

CGT

There is no tax due on the transfer using this method as no CGT is due on death

Frederick would acquire the property at the probate value

IHT

The tax attributable to the legacy of the property at death would be
(211,020 – 6,000) at 40%

£ 82,008

b)

IHT:

This gift would be a PET and therefore no IHT would be due immediately

If Ms Honeychurch survived for seven years after making the gift, no IHT would be due

CGT:

	£		
Deemed proceeds - market value of the property:	211,020		
Less cost of the property	-70,000	)	
Agent's fees	-3,000	)	
Untapered gain (No indexation as after 4/98)	138,020		
Less taper relief for a non-business asset 09.05.2002 to 07.11.2007			NBA
5 years = 15% relief	-20,703		15%
85% chargeable	117,317		
Less annual exemption for 2006/07	-8,800	)	
		)	

Chargeable gain	108,517	)
		)
Tax due at 40%	43,407	)

No gift relief under s165 CGTA as this property is not a business asset
No CGT holdover relief under s260 CGTA as this transfer is not a CLT for IHT purposes

c)

	£
The CGT charge would remain, as before.	43,407
The property would become part of Ms Honeychurch's estate as a PET within the last 7 years. No taper would apply	
The IHT charge would be at 40%	
211,020 x 40%	84,408
	127,815

The IHT would need to be paid by Frederick

d)

If Ms Honeychurch continues to enjoy the use of the property for two months every summer, then this gift would be captured under the gifts with reservation of benefit rules.

The value of the property would remain in Ms Honeychurch's estate for IHT.

If the reservation of benefit is released at a later date, then the Revenue would treat the gift as a PET at that date.

The Revenue will prepare two IHT computations; one based on the PET and one with the property in the death estate computation and use the one with the higher tax liability.

GWROB could be avoided by Ms Honeychurch paying a market rate to Frederick for all of her stays at the holiday home.

Answer 2

ABC Limited
1 High Street
Newtown

7 November 2007

Dear Mr Jones

Thank you for your recent letter. I am setting out the answers to your questions.

Capital Gains Tax

The trust will need to pay Capital Gains Tax of £8,345 in respect of the disposal of the property. My calculation of this sum is shown in the appendix.

The tax is payable on 31 January 2009.

Other tax liabilities

In addition to the CGT liability, there will be an income tax liability on rental income received by the trustees from August 1992 – August 1996 and May 2004 – June 2007. The trustees may have allowable expenses to set against this income. The trust will also be liable to income tax on any interest received from its cash deposits.

A 10 year charge should also have been paid in 1987, 1997 and 2007, on the value of the assets in the trust at 6%. An exit charge will have been incurred if capital has been distributed from the trust.

Disclosure to HMRC

If the existence of the trust has never been made known to HMRC, then the window of enquiry will be 20 years (instead of the normal six) as failure to notify would amount to negligence. HMRC can apply for penalties of 100% of the tax due (income tax and IHT), though these can be mitigated by factors such as the gravity of the situation, whether there has been voluntary disclosure of the omission and cooperation with the investigation. Interest will be charged on any outstanding tax from the normal due date until the date of eventual payment.

We advise full disclosure at the earliest opportunity. Ignorance on the part of you or your sister is no defence, and your position as a professional and trustee may lead to a higher penalty weighting.

Yours sincerely

Appendix

The CGT due is calculated as follows:

	£	
Proceeds	450,000	
MV 1982	(70,000)	
Enhancement	(29,375)	

	350,625	
Indexation Allowance (1.047)	(73,290) ---------	
Indexed Gain	277,335	
Total ownership since 1982 (304 months)		
Exempt periods:		
41 months (Uncle)		
83 months (daughter)		
54 months (brother)		
Last 36 months (deemed) (= Total 214 months		
Non Exempt Gain 90/304	82,105	
Gain during letting period £277,335 x 52/304 = £47,439		
Lettings relief (maximum)	(40,000)	

Untapered gain	42,105	
Non BATR (40%)	(16,842)	

Chargeable Gain	25,263	
Trust's exemption	(4,400)	

Taxable Gain	20,863	
	=====	
Tax at 40%	£8,345	

ANSWER 3:

1. Although this is not a settler-interested trust for income tax purposes, as the trust was set up by Mr Davies, the income distributed to Adam (being a minor) will be taxed on Mr Davies himself as it exceeds £100.

2. CGT calculation
The gains will be assessable on Mr Davies as the trust is settler-interested for capital gains tax purposes:

	£	
Proceeds	37,269	
(2,200 x $5.87 = 12,914/0.3465)		
Less Cost (W)	(13,411)	

Unindexed gain (No indexation)	23,858	
Less Mr Davies' capital loss	(2,000)	

	21,858	
Less Taper relief (7 years – no bonus year - 25%)	(5,465)	

Chargeable gain (75%)	16,393	
Less Annual Exemption	(8,800)	

Chargeable gain	7,593	
	=====	
Tax Due:		
£33,300 – (29,035 + 4,000 – 5,035) = 5,300 @ 20%	1,060	
£7,593 – 5,300 = 2,293 @ 40%	917	

	1,977	

Working

Value of shares transferred into trust:

	£
20,000 x $1.98/0.3184 =	124,372
Less held over gain	(2,450)
Revised base cost	121,922

Cost of shares sold:

£121,922 x 2,200/20,000 = 13,411

3. Income tax due on trust income

	£	£	£	£	£	
	Non savings	Savings	Dividends	Tax Due	Tax Paid	
Rental Income	24,286				0	
Bank deposit interest - £1,200 x 100/80		1,500			300	
Solicitor's client account - gross		402				
Dividends £315 x 100/90			350		35	
Less trustees' expenses: £315 x 100/90 (1,400 – 315) x 100/80		(1,356)	(350)			
Taxable	24,286	546	Nil			
Tax Liability:						
£1,000 @ 22%				220		
Non savings £24,286 – 1,000 @ 40% =				9,314		
Savings @ 40%				218		
Trust expenses:						
Dividends 350 @ 10%				35		
Interest 1,356 @ 20%				271 --------		
Total Liability				10,058		
Less Tax Paid				(335)		

Tax payable				**£9,723**		

4.
If a person dies intestate, the law divides the estate in a particular way. The main residence and joint building society account balance will automatically be transferred to Mr Davies as joint tenant.

The remainder of the estate is divided. The spouse takes the personal chattels, plus £125,000, and has a life interest in half of the residue.

The children take the remaining half of the residue. As one of the sons is a minor, any assets allocated to him will be held in a trust until he becomes 18 years old.

Scots Law

The surviving spouse has a prior right to the deceased's dwelling house, if they were ordinarily resident there at the date of death, up to a statutory maximum value, currently £300,000.

In addition, the surviving spouse is entitled to the contents of the dwelling house up to a statutory maximum value, currently £24,000.

The surviving spouse is entitled to financial provision out of the deceased's estate. As there are children, the amount of provision is £42,000.

Legal rights are available from the moveable estate remaining after prior rights. The spouse gets one third of the moveable estate. The children share the remaining two thirds of the moveable estate, and get any remaining heritage.