



The Chartered Tax Adviser Examination

May 2009

Inheritance Tax, Trusts & Estates

Advisory Paper

TIME ALLOWED – 3 HOURS

- You should answer all of the questions.
- Start each answer on a new sheet of paper and write on one side only. Do not write in the left-hand margin.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer the law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of each answer folder.

1. You have agreed to give a lecture on bare trusts to your local branch of The Chartered Institute of Taxation.

You are required to prepare notes in advance of the lecture setting out the content of the lecture. Your lecture should address the following points:

- 1) **The definition of a bare trust, giving examples of different types of bare trust.**
- 2) **The treatment of bare trusts for Income Tax, Capital Gains Tax and Inheritance Tax.**
- 3) **The tax planning opportunities offered by bare trusts.** (10)

2. David Jones died on 1 June 2007 leaving a gross estate of £400,000. In his will, he left £100,000 to charity and the residue of his estate to his son Alex.

The administration period ended on 31 January 2009. Income received by the executors was as follows:

<u>Income</u>	<u>2007/08</u>	<u>2008/09</u>
	£	£
Rents received	11,000	Nil
UK dividends	12,600	Nil
Bank Interest (net)	2,960	4,800
<u>Expenses</u>		
Property expenses	1,900	Nil
Administration expenses	600	450

On 4 December 2007, the executors made a distribution on account of Alex's entitlement to residue by transferring to him shares belonging to the deceased which had a current market value of £100,000 and a probate value of £90,640. Other than the legacy to charity, the rest of the estate was distributed on 31 January 2009.

On 12 March 2008, the deceased's investment property was sold for £180,000. The probate value was £161,500. In selling the property the executors incurred estate agents and legal costs of £3,250.

On 6 April 2008, Alex signed a deed of variation of his father's will whereby 25% of the residuary estate passed to Alex's impoverished cousin Josephine. The deed of variation provided that Josephine was to receive the income attributable to her share of the residue from the date of David's death. The deed of variation included statements that s.142(1) Inheritance Tax Act 1984 and s.62(6) TCGA 1992 are to apply to the variation.

You are required to:

- 1) **Compute the executors' Income Tax and Capital Gains Tax liability for 2007/08 and 2008/09.** (8)
- 2) **Compute the amounts of residuary income due to Alex and Josephine in each year of the administration period.** (8)
- 3) **Compute the additional Income Tax payable by him, assuming that Alex is a higher rate taxpayer, in respect of the estate income for all relevant years.** (4)

(4)
Total (20)

3. Jane Harries died on 12 August 2008, domiciled within the UK. She was survived by her three children and four grandchildren.

From 2003 onwards, each Christmas Jane gave £250 each to her grandchildren. For Christmas 2003 only, she also gave £3,000 to each of her children.

A sum of £10,000 was donated by Jane in July 2004 to a Spanish charity established in Marbella for the care of Spanish orphan children.

When her god-daughter was married on 19 March 2005, Jane gave her £5,000.

On 12 June 2005 Jane established an Accumulation and Maintenance trust, qualifying under s.71 IHTA 1984, for her grandchildren, and gifted £500,000 to the trustees.

Jane lent £50,000, interest free and repayable on demand, to her nephew Henry in August 2006.

On 20 March 2008, Jane gifted £275,000 cash to create a discretionary trust which she established for her children.

At the time of her death, Jane owned the following assets:

- 1) Her home in London, valued at £650,000 for probate purposes, but sold in April 2009 for £575,000.
- 2) The contents of the London house, valued at £25,000.
- 3) A villa in Spain, valued at £200,000.
- 4) 10,000 shares in Universal Widgets plc. The closing bid and offer prices quoted in the Stock Exchange Daily Official List for the company at the date of death were £2.30 and £2.34. The shares were sold four months later for £1.20 each.
- 5) 2,000 shares in Bolivian Copper plc. The closing bid and offer prices quoted in the Stock Exchange Daily Official List for the company at the date of death were £15.10 and £15.70. The shares were sold four months later for £15.60 each.
- 6) 49 of the 100 issued shares in Catalonia Growers SA, a successful Spanish company established by Jane's son, Kenneth, which grows salad crops in Spain for the export market. Kenneth owns the remaining 51 shares. Jane acquired the shares in 2004. The shareholding is estimated to have a value of £100,000. Jane also has money owing to her on director's loan account with the company. At the date of death the sterling equivalent market value of the loan is £50,000.
- 7) £55,000 in bank and building society accounts in London.
- 8) £200,000 in an Isle of Man bank account.

The will directs the executors to write off the loan to Henry, leaves the Catalonia Growers shares to Kenneth (free of tax), and all other assets to the two other children equally.

You are required to:

- 1) **Calculate the Inheritance Tax payable as a result of Jane's death, showing separately the amount payable in respect of the deceased's estate on death, and the amount(s), if any, payable in respect of Jane's lifetime gifts. Explain, briefly, your treatment of each item and any reliefs which you consider due.** (17)
- 2) **State who is liable for the tax and the due dates for payment of the tax.** (3)

Total (20)

4. Mr Smith, a UK domiciled and resident individual, created a UK life interest trust on 10 September 1996. He is the life tenant and thereafter the trusts become fully discretionary for the benefit of any surviving widow, children and other descendants. While the life tenancy continues, the settlor and his family can, at the trustee's sole discretion, be appointed/advanced capital or other benefits from the trust.

He had created the trust by settling 50,000 shares in Smithco Ltd, an unquoted trading company, worth about £300,000. A chargeable gain of £100,000 had been held over under a s.165 TCGA 1992 claim.

On 10 March 2008, the shares in Smithco Ltd were sold to a private equity backed acquiring new company (Buyerco Ltd), for cash of £100,000, preference shares worth £200,000 and 100,000 ordinary shares worth £200,000 (2% shareholding). The trustee placed the cash on deposit and has retained the non-cash consideration.

On 10 March 2009, the trustee received a communication from the new owner advising that a refinancing strategy has been agreed with the private equity backer. The main terms are as follows.

- 1) The existing preference shares are considered to be worth a nominal amount and will be cancelled.
- 2) The ordinary shares are also considered worthless but it is proposed to have a rights issue to raise extra finance. To reflect the difficulties in raising debt finance the terms are expected to be two new shares for one existing share at a rights price of £1 per new share.

The trustee is seeking specialist corporate finance advice on the investment aspects of the restructuring and in particular whether or not to take up the rights issue and how to fund it.

You are required to draft a memo to the tax partner advising him of the UK Capital Gains Tax and Inheritance Tax issues that the trustee should consider with regard to the restructuring proposal, in particular funding the rights issue.

(15)

5. An overseas lawyer well known to your firm has telephoned you. They have a client who is a Freedonian citizen who for personal and business reasons is thinking of coming to live in London for the foreseeable future.

The client's wealth is held in what would for UK trust law purposes be called an interest in possession trust, which he settled in 1989. During the call the following additional information has been obtained.

- 1) The trust holds a very substantial portfolio of quoted stocks and bonds in overseas corporations and various offshore funds.
- 2) The trust owns 100% of the client's unquoted overseas holding company under which all his various business interests are held.
- 3) The terms of the trust provide that the settlor is entitled, as described, to the trust income. The trustee can appoint/advance capital at their discretion subject to the consent of the settlor.
- 4) Quite a few trust actions such as investing trust funds and expenditure over a certain value are also subject to the consent of the settlor.
- 5) The trustees of the trust are the overseas lawyer and the settlor.

Continued

5. *Continuation*

- 6) The client's plans are to buy a London house and move his family here. He is married to a lady who originally came from London and they have two children. The children will move to UK schools. He will base himself in London returning here after trips abroad. The intention is to be based in London for at least five years until the children have completed their education and new business enterprises established are up and running. Thereafter he intends to return to Freedonia.

The overseas lawyer is concerned that there may be UK Capital Gains Tax consequences for the trust due to the settlor moving from Freedonia to the UK.

You are required to prepare a technical note explaining the UK Capital Gains Tax consequences for the trust of the settlor's move to the UK and where appropriate making recommendations. You should ignore non-UK tax issues. (15)

6. One of your clients, Mr Waters, settled a trust with £500,000 cash on 5 March 2001. The trustee agreed to pay any tax due. Under the terms of the trust his spouse was entitled to 50% of the trust income for life and the balance of trust income was payable at the discretion of the trustees to his three children. Capital could be appointed/advanced at the discretion of the trustees. Mr Waters was in the class of beneficiaries of the trust.

Mr Waters died on 1 December 2007 at which time his personal assets were limited to cash of £375,000. His will left a legacy, bearing its own tax, of £75,000 to the trust and the balance of his estate to his widow. He had made no lifetime transfers apart from the set up of the trust. At time of his death the trust fund was worth £550,000, split equally between the discretionary and life interest parts. No trust income had been accumulated.

On 20 August 2008 the trustees made a capital appointment of £20,000, net of any taxes.

On 5 March 2011 the trust fund was valued at £620,000 split equally between the discretionary and life interest parts.

All individuals were UK domiciled at all times.

You are required to calculate the Inheritance Tax payable in respect of each event, assuming all relevant reliefs are claimed where beneficial and that the 2008/09 rates of tax continue unchanged for future years. You should provide explanations to support your calculations. (20)