

THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Inheritance Tax, Trusts & Estates

TIME ALLOWED
3 HOURS 30 MINUTES

- In order to secure a pass in this exam, you will be required to demonstrate competence in each of three skills.

You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots Law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information, you may assume that 2019/20 legislation (including rates and allowances) continues to apply for 2020/21 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

You are a tax associate in a firm of Chartered Tax Advisers. Your Tax Director, Karen Palmer, has received a letter (**EXHIBIT A**) from a longstanding client, Mr Robert Hodgson, who is the lead trustee of The Hodgson Discretionary Trust which was settled by his father, Mr David Hodgson. Robert is aware that the trust will end shortly and wants to ensure that the taxation implications of that cessation and the options open to the trustees are considered in advance.

Karen has asked you to review his letter alongside the file notes detailing the trust assets (**EXHIBIT B**) and the previous tax charge history (**EXHIBIT C**) before preparing a draft report to the trustees addressing the queries Robert has highlighted in his letter.

The following exhibits are provided to assist you:

- EXHIBIT A:** Letter dated 30 October 2020 from Robert Hodgson to Karen Palmer
- EXHIBIT B:** File note – Valuation of Hodgson Discretionary Trust (last updated 2 November 2020)
- EXHIBIT C:** Inheritance Tax Charges
- EXHIBIT D:** Pre-seen information

Requirement:

Prepare a draft report to the trustees of The Hodgson Discretionary Trust, for review by Karen Palmer, which advises on the taxation implications of the winding up of the trust and recommends any actions that the trustees should consider to minimise tax liabilities.

Continued

Continuation

EXHIBIT A

Letter dated 30 October 2020 from Robert Hodgson to Karen Palmer

Mrs Karen Palmer
Novus Chartered Tax Advisers
Cambridge
CB1

Mr R Hodgson
The Willows
Cambridge
CB1

30 October 2020

Dear Karen

Hodgson Discretionary Trust

I wanted to write to you to request advice on what steps (if any) the trustees should be taking now to mitigate any tax charges that may arise on the winding up of the trust next year.

As I am sure you remember, my father settled the trust during his lifetime for his lineal descendants with his grandchildren as the remaindermen. My father never wanted the trust to continue for a significant period and so the terms of the trust were set that the trust would end 21 years after his death, which will be May 2021. His only grandchildren are my children, Susan and Oliver.

Prior to the trust cessation, I know we have an Inheritance Tax 10-year charge this December and I would like to know what you expect this tax charge to be so that we can consider if there will be sufficient cash to settle it without selling trust assets.

We then need to plan for the winding up of the trust and the trustees are open to suggestions so long as the assets eventually received by each of my children are of equal value. I have been speaking with Oliver and he has informed me that, following a period of renting, he hopes to buy a house for £550,000 in Bath in the first quarter of 2021.

To fund this purchase, Oliver will use his savings of £100,000 and he is selling his flat in London which he has rented out to produce an income since he inherited it in 2010 from his maternal uncle. He acquired the property at a probate valuation of £700,000 but it has recently been discovered that the whole block of flats has significant structural issues. Oliver has received an offer of £500,000 which he has accepted, but he has been informed by the sales agent that the sale is likely to be very slow due to the number of searches and structural reports the buyer will be undertaking. Exchange and completion is therefore not expected until the second quarter of 2021.

I was therefore wondering whether we could distribute Oliver's share of trust assets to him early? He could then sell them and use the funds to purchase his desired property in Bath thereby avoiding the risk of the purchase falling through because of the delay in selling the London flat. I have spoken with Oliver about this idea and he was delighted, suggesting that if the trust could transfer the assets to him in early January he would have time to sell them to enable the Bath purchase to take place within the planned timeframe. This would also mean that he would not need the bridging loan offered by the bank which is expensive carrying a flat fee of £2,000 per month. He did also say to me that he intended to sell the trust assets in any case as he wanted to buy a couple of rental properties around Bath in the coming years. Oliver has little appetite for stock market investments following the capital losses he incurred a few years back.

I have also spoken to Susan about the trust assets. She is planning on retaining the shares for the long-term income and further capital growth and is therefore unconcerned about timing.

If you need any further information, please do let me know. I look forward to hearing from you.

Yours sincerely

Robert Hodgson

Continued

Continuation

EXHIBIT B

File note – Valuation of Hodgson Discretionary Trust (last updated 2 November 2020)

Trust Name Hodgson Discretionary Trust

Background Trust funds have always been invested in the banking sector due to backgrounds in the sector of both the settlor and lead trustee. Overall performance has been excellent over the years but very volatile.

This trust will cease on 3 May 2021, 21 years after the death of the settlor. Assets to be transferred to remaindermen – the two adult grandchildren, Susan and Oliver.

Assets held (updated 2 November 2020)

Shares and securities

<u>Name</u>	<u>Stock Market Listing</u>	<u>Number of Shares</u>	<u>Total Cost £</u>	<u>Total Market Value £</u>
Traditional Banking plc	London Main Market (LSE)	350,000	172,000	734,360
Digital Bank plc	Alternative Investment Market (AIM)	50,000	50,000	369,278
International Bank plc	American Stock Exchange (NASDAQ)	6,000	98,000	258,647
			<u>320,000</u>	<u>1,362,285</u>

Cash account balances (in £ sterling)

	£
UK bank account	22,000
US bank account	5,000
Stockbrokers Account (holds income only)	8,000
	<u>35,000</u>

Total assets

1,397,285

Made up by:

Capital account	1,389,285
Income account (all less than five years old)	<u>8,000</u>
	<u>1,397,285</u>

Notes

- 1) The tax pool brought forward as at 5 April 2020 amounts to £18,983.
- 2) Digital Bank plc is a new start up challenger bank to the banking market. This security was purchased during an initial public offering on 7 June 2017.

Continued

Continuation

EXHIBIT C

Inheritance Tax Charges

Charge on 22 December 2010

	£	£
Asset values as at 22 December 2010		
Traditional Banking plc	212,547	
International Bank plc	123,689	
UK bank account	8,000	
US bank account	3,000	
Making up capital account balance of:		347,236
Nil rate band as at 22 December 2010 (2010/11)	(325,000)	
Settlor's chargeable transfers in seven years prior to creation	50,000	
Distributions in 10 years prior to 22 December 2010	-	
Nil rate band remaining		(275,000)
		72,236
Notional tax at 20%		14,447
Effective rate		4.161%
Actual rate		1.248%
Tax charge (1.248% x £347,236)		4,333

Projected Inheritance Tax charge as at 22 December 2020 (updated 2 November 2020)

Projected Effective rate of 14.606%

Continued

Continuation

EXHIBIT D

Pre-seen information

Client

The Hodgson Discretionary Trust

The Trustees signed the firm's new GDPR compliant engagement letter covering compliance and advisory services on 14 July 2018.

Trust created

22 December 1990

Settlor

Mr David Hodgson

Trustees

Mr Robert Hodgson (Lead)
Mr James Saunders (Friend of Settlor)

Beneficiaries

All lineal descendants of Mr David Hodgson

Mr Robert Hodgson	born 12/09/1961	Son of Settlor (Widowed)
Miss Susan Hodgson	born 13/07/1983	Granddaughter of Settlor
Mr Oliver Hodgson	born 26/10/1985	Grandson of Settlor

Mr Robert Hodgson has employment income in excess of £100,000.

Miss Susan Hodgson has rental income and higher rate employment income. Has no capital losses and does not utilise her annual exemption. Susan has never married, has no children and is UK resident for tax purposes.

Mr Oliver Hodgson has rental income and higher rate employment income. Has brought forward capital losses of £50,000 but no longer uses his annual exemption. Oliver has never married, has no children and is UK resident for tax purposes.

Initial Trust Fund

£100,000 cash.

The funds have been invested primarily in stock market securities in the banking sector for the full duration of the trust to date.

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Continuation

Terms of trust

The terms have been unchanged since creation. Key clauses are:

- 1) The capital and income of the trust fund shall be held at the sole discretion of the trustees for the benefit of the settlor's lineal descendants.
- 2) The trust shall cease 21 years after the death of the settlor and the assets shall pass to the Grandchildren of the settlor living at this date.
- 3) The trustees may at any time or times during the trust period accumulate income generated and hold these funds as capital of the trust.
- 4) The Trustees may at any time or times during the trust period transfer or raise and pay the same to or for the absolute use and benefit of a beneficiary as they see fit.

Information relating to Settlor

Born: 12 June 1940
National Insurance Number: JR782500C
Domicile: England & Wales
Residence: Oak View Farm
Cambridge
CB3
IHT Reference: L404592/02B

Gifting History

01/12/1990 £50,000 in cash to The 1990 Family Discretionary trust (ceased in 1996, all assets were appointed to Robert Hodgson)
22/12/1990 £100,000 in cash to The Hodgson Discretionary Trust
11/04/1996 30,000 shares in Traditional Banking plc to Mr Robert Hodgson
17/08/1999 10,000 shares in Traditional Banking plc to Mr Robert Hodgson

Assets:

Listed share portfolio Value - £2 million
Main residence Value - £1 million
Cash at various institutions Value - £1 million

Will summary

All assets to be left absolutely to his only Son, Mr Robert Hodgson.