

The Chartered Institute of Taxation

Advanced Technical

Inheritance Tax, Trusts & Estates

November 2022

Suggested solutions

Question 1:

(1) Application of Business property relief (BPR) to Zennie's shareholding in Zennie Group Ltd

BPR is only available for holdings in unquoted companies which have been held for more than two years (s106 IHTA 1984). These requirements are satisfied.

It is also necessary that the company is a trading company or the holding company of a trading group.

Trading Company Test

A company (or group) is trading if it is wholly or mainly trading (s105(4)(b) IHTA 1984). This means that more than 50% of its activities must be trading. There is no further definition to expand on what this means. It is necessary to take an overall view by reference to profits, assets, turnover, management time and context of the business.

Zennie Group Ltd is not itself a 'trading' company because it only holds shares but relief will be available if its business is that of wholly or mainly a holding company of a trading group. Each subsidiary must be considered separately and its value (reflected in the share value of Zennie Group Ltd) will be excluded from relief to the extent it is not wholly or mainly a trading company (s111 IHTA 1984).

The interest in Citrine Ltd is less than a 51% holding and so is not a subsidiary (see s1159 CA 2006) rather it is treated as an investment asset of Zennie Group Ltd. The value of Citrine Ltd is £2 million (40% x £5 million), ignoring any minority discount. This is clearly significantly less than 50% of the value of Zennie Group Ltd - it does not dominate and so does not alter the latter's business as being that of wholly or mainly a holding company of a trading group.

All other companies in the group are subsidiaries. Whilst Amber and Emerald have non-trading activities, these do not represent more than 50% of the value of these companies. Accordingly, no subsidiary is excluded from relief. There is no geographical restriction on the location of the business for BPR purposes so it does not matter that Bloodstone only operates in Malta. Whilst the holding of shares in the parent must have been held for more than two years, there is no such test on a parent's ownership of its subsidiaries and therefore it does not matter that Diamond has been acquired recently.

The total value of the group is £67 million (£50million + (3 x £5million) + (40% x £5million)) and at least £38.8million of the value of Amber is pure trading which is far in excess of 50% of the value of the group. It is clear that overall the group meets the trading test and BPR will be available on the whole value of the group, including Citrine Ltd, subject to the excepted assets rules.

Excepted Assets

Assets neither used wholly or mainly in the business of a trading subsidiary for the past two years nor required for its future use and assets used for personal benefit will be treated as 'excepted assets' (s112 IHTA 1984). The value of excepted assets will not qualify for relief.

- 1) Amber Ltd – It has cash of £2.5 million which is not used in the business and it also holds Zennie's personal yacht which is used wholly for her personal benefit (s112(6)). The value of both will be excepted assets and will not qualify for relief.
- 2) Bloodstone Ltd – It is wholly trading and has no excepted assets.

3) Diamond Ltd – It is wholly trading and has no excepted assets.

4) Emerald Ltd –As the share portfolio is used in the wider 'business' of the company, the portfolio is not an excepted asset.

(2) Application of BPR to 'The Glade' and acquisition vehicle

It is very unlikely that furnished holiday lets (FHLs) will qualify for BPR. The letting of land covers the spectrum of a fully serviced hotel which will qualify as 'trading' to the bare letting of land which will not.

Purchasing 'The Glade' in the newly incorporated subsidiary would mean that FHLs would be the sole business of the company. The subsidiary would then fail the wholly or mainly trading requirement and its value, reflected within the shareholding of Zennie Group Ltd, would be excluded from relief under s111.

Purchasing 'The Glade' in Emerald Ltd would mean that the FHL business would be held alongside the hotel business. However, the trading element of the latter would still dominate overall and the subsidiary would remain wholly or mainly a trading company. So the value of Emerald would not be excluded from relief under s111.

The FHLs would form part of the wider 'business' of Emerald Ltd and as such would not be treated as an excepted asset under s 112.

Therefore, the best place to hold 'The Glade' is in Emerald Ltd.

MARKING GUIDE

TOPIC	MARKS
1) <u>Application of BPR to Zennie's shareholding in Zennie Group Ltd</u>	
Shares held for more than two years (s106 IHTA 1984) and in an unquoted company	1
Zennie Group Ltd is not a 'trading' company.	1
Holding company rule s105(4)(b) IHTA 1984.	0.5
Citrine Ltd – not a subsidiary as defined so not subject to the rules in s111/s112 and treated as an investment asset of the holding company.	1
Value is not more than 50% of the whole value of Zennie Group Ltd so still wholly or mainly a holding company and if used in the business of Zennie Group Ltd relief will be available on its value as well.	1
Assess the group as a whole to see whether it is a trading group – >50% test. Conclusion - trading group on relative asset values (given large value of obviously trading Amber Ltd).	0.5
Examine each subsidiary. If wholly or mainly investment exclude value of the whole subsidiary s,111 IHTA 1984	1
If the subsidiary has any investment assets, these will also need to be assessed to see if they are 'excepted assets' s112 IHTA 1984. If so exclude their value.	1
Amber Limited – Clearly a trading company so s111 does not exclude its value	0.5
£2.5million excepted asset (not used in business) so value excluded.	0.5
Zennie's yacht is an excepted asset (not used in the business) personal asset s112(6) Its value will be excluded.	0.5
Bloodstone Ltd – It doesn't matter that it operates in Malta as no territorial limit	1
Diamond Ltd – Doesn't matter when the shares were acquired by the group as two year holding test on holding company	1
Emerald Ltd – s112 IHTA 1984 uses the word 'business' not trade when looking at excepted assets.	0.5
Portfolio will not be an excepted asset as used in the company's business but will be excepted if not so used.	0.5
All of the value of the company will be eligible for BPR but restricted for excepted assets.	0.5
Subtotal	12

(2) Application of BPR to 'The Glade' and acquisition vehicle	
Unlikely that FHLs will qualify for BPR. Likely investment unless FHLs have necessary level of services (re.Pawson/Cox)	1
Purchasing The Glade in a new subsidiary - whole value of subsidiary would not qualify for BPR because of s111.	0.5
Consider excepted assets rules - FHLs would be part of the business of Emerald Ltd and s112 IHTA 1984 means that these would not be excepted assets	0.5
For correct recommendation: Emerald Ltd/ Recognising that Emerald gives relief where a newly incorporated subsidiary would not	1
Subtotal	3
GRAND TOTAL	15

Question 2:

(1) Trust termination before Kaja's re-marriage, absolute gift to children

IHT

Kaja's interest is an immediate post death interest (IPDI). Termination of that interest in her lifetime with the transfer of trust assets to the children will be a deemed PET made by Kaja. If she gives notice to the trustees within six months of the transfer, her 2022/23 and 2021/22 annual exemptions can be used against this. BPR will be available on the shares in the trading company, so the value of the PET will be £4,010,000-£6,000-£1,700,000=£2,304,000

The PET will be fully exempt if Kaja survives seven years from the trust termination else the PET will fail and the BPR position on the shares will need to be retested. If the shares are not held by the recipient at that point (or replaced with qualifying property) relief will be clawed back. The trustees will be primarily liable for any IHT arising and should take appropriate indemnity or insurance.

CGT

A chargeable event for CGT will arise when the children become absolutely entitled. No holdover relief will be available under s260 TGA 1992 as there is no immediate charge to IHT.

	Base cost £	Market value £	Gain £	Loss allocated £	Exemption/ election £	Chargeable gain £	Note
Shares in Quality Sausages Ltd	1,300,000	1,700,000	400,000		(400,000)	-	4
Main residence	500,000	750,000	250,000		(250,000)	-	1
Quoted share portfolio	600,000	550,000	(50,000)	50,000		-	
Investment property	250,000	310,000	60,000	(50,000)		10,000	
Collection of motorbikes	190,000	700,000	510,000		(510,000)	-	3
					Annual exemption	(3,075)	2
		<u>4,010,000</u>			Taxed at 28%	<u>6,925</u>	
					Total CGT due	<u>1,939</u>	

As the net gain is wholly attributable to residential property the CGT must be paid and a return made within 30 days of trust termination.

Note 1: As Kaja has an IPDI and has occupied the main residence as her home, private residence relief will be available under s225 TCGA 1992 and no gain will accrue on the disposal of the property if a claim is made by the trustees.

Note 2: Theo had previously settled another trust, so AE is reduced - £6,150/2=£3,075.

Note 3 No CGT on motorbikes as they are wasting assets.

Note 4: s260 TCGA 1992 holdover relief is not available as no charge to IHT but s165 TCGA 1992 holdover relief will be available as they are unquoted shares in a trading company. A joint election will be needed by the trustees and beneficiaries.

(2) IPDI termination before Kaja's re-marriage, assets continue in trust for children

IHT

Kaja will be treated as having made an immediately chargeable lifetime transfer and the trust will enter the relevant property regime at that point.

	£
Transfer of value	4,010,000
BPR on shares	(1,700,000)
AE22/23	(3,000)
AE21/22	(3,000)
CLT	<u>2,304,000</u>
Nil rate band (N1)	<u>(137,000)</u>
	<u>2,167,000</u>
Tax thereon at 20%	<u>433,400</u>

(N1) NRB =£325,000-£74,000-£114,000=£137,000. i.e. deduct CLTs made in the previous seven years, less 2 x AEs on each.

(N2) BPR will be available on the shares as they are in an unquoted trading company and have been held for two years. If Kaja dies within seven years the BPR position will be retested and additional tax will be due if the assets are not still held by the trustees or if the company fails to meet the BPR conditions at that time.

The trustees should be aware that a PET has been made before the CLTs which if Kaja died within seven years thereof additional IHT would be due as her NRB would be used against that failed PET first.

CGT

There is no CGT disposal by the trustees as the trust continues. The assets are not rebased to their current value.

(3) Trust termination on Kaja's death, assets pass to children

IHT

On Kaja's death, the market value of the Trust assets will be aggregated with her estate and subject to IHT payable out of trust funds.

The IHT will be calculated as follows:

	£
Stockmarket portfolio	250,000
Value of trust	4,010,000
BPR on shares	<u>(1,700,000)</u>
	2,560,000
Less NRB	<u>(43,000)</u>
	<u>2,517,000</u>
IHT at 40%	<u>1,006,800</u>

Apportioned:

Personal estate:

$\text{£}1,006,800 \times \text{£}250,000/\text{£}2,560,000 = \text{£}98,320$

Settled estate:

$\text{£}1,006,800 \times \text{£}2,310,000/\text{£}2,560,000 = \text{£}908,480$

No transferrable NRB is available as Theo used his NRB in full on death.

Kaja's free estate is left to her sister Aggie, but the IPDI holding her residence terminates in favour of her step children and so is 'closely inherited' and therefore RNRB is potentially available. However, when aggregating the value of the trust with the death estate, the threshold of £2.35m is exceeded and so the RNRB is tapered away in full.

N1: NRB calculation

	£	£
NRB		325,000
Jan 2017 Gift	100,000	
AE16/17	(3,000)	
AE15/16	(3,000)	
NRB	<u>(94,000)</u>	(94,000)
	-	
Mar 2019 Transfer	80,000	
AE18/19	(3,000)	
AE17/18	(3,000)	
NRB	<u>(74,000)</u>	(74,000)
	-	
May 2020 Transfer	120,000	
AE20/21	(3,000)	
AE19/20	(3,000)	
NRB	<u>(114,000)</u>	(114,000)
NRB available		<u><u>£43,000</u></u>

CGT

The trust assets pass to the children with an uplifted market value because of Kaja's death. No CGT will be due.

MARKING GUIDE

TOPIC	MARKS
PET as termination of IPDI/ seven year survival	1
Value of PET – less 2 AEs if notice given & time limit	1
Value of PET – less BPR on shares	0.5
Trustees - liable for any IHT arising on her death if PET fails plus if BPR clawed back	1
Actual disposal for CGT and no holdover under s260 – no IHT liability	1
QSL shares – s165 holdover – joint election	1
Main residence – PPR	1
Quoted shares – loss £50k to offset against other gains in year	0.5
Investment property – residential property so at 28% rate and filing requirement	1
Motorbikes – wasting chattels - exempt	0.5
AE – two trusts – so £3,075	1
<i>Termination on re-marriage and remain in trust</i>	
CLT immediately chargeable – due by trustees.	0.5
Trust has entered the relevant property regime; s80 provides that Kaja is settlor	1.0
2 x AEs	0.5
Less BPR	0.5
NRB = £325,000 - £74,000 - £114,000 = £137k. ie deduct the CLTs made in the previous seven years, less 2 x AEs on each.	1
IHT at 20%	0.5
trustees should beware that a PET has been made before the CLT – death within 7 years = further IHT due	0.5
BPR could be withdrawn as retested if death with 7 years – also could result in further IHT	0.5
No CGT due as no disposal, trust continues; no rebasing	0.5
<i>Termination on death and pass to children</i>	
IHT calculated on MV at death/forms part of death estate	0.5
Include stock market portfolio held personally	0.5
Less BPR on QSL	0.5
Calculation of NRB to include failed PET	1
TNRB and RNRB position	1.0
Tax at 40%	0.5
Show tax due by each component	1
No CGT due on death – uplifted to MV	1
TOTAL	20

Question 3:

Inheritance Tax (IHT) and Capital Gains Tax (CGT) due on trust creation

The Property Trust is treated as settlor-interested for CGT as the settlor's spouse can benefit (s169F TCGA 1992). For CGT purposes this means that no holdover relief can be claimed on set up, notwithstanding the fact that an IHT charge accrues.

The trust is also treated as settlor-interested for IHT because Cora is able to benefit from the assets. Therefore, though IHT will arise on setting up the trust, it will also be treated as a gift with reservation of benefit and the trust assets will be deemed to remain within Cora's estate for IHT purposes.

CGT on set up

	£
Market value	2,500,000
Base cost	<u>(800,000)</u>
	1,700,000
Annual exemption	(12,300)
	<u>£1,687,700</u>
At 28%	<u>£472,556</u>

This is due by Cora. As it is residential property it should have been reported and the CGT paid within 30 days.

The CGT was therefore due on 9 June 2020.

IHT – due on trust creation

	£
Loss to estate	2,500,000
Annual exemption 20/21	(3,000)
Annual exemption 19/20	<u>(3,000)</u>
CLT	2,494,000
Nil rate band (N1)	(231,000)
	<u>£2,263,000</u>
Chargeable to IHT	<u>£2,263,000</u>
IHT at 20/80	<u>£565,750</u>

N1 = 2018 gift £100,000 less 2 x AE £3k each = £94,000. NRB £325k less £94k = £231k

IHT was due by Cora on 30 April 2021 and has been grossed up to reflect this.

IHT due on Cora's death

Cora had a gift with reservation which will be charged to IHT in her death estate, but there was also a CLT in respect of the same property which will also be charged to IHT as made within seven years of death. The Double Charges Regulations SI1987/1130 (regulation 5) will apply to calculate the IHT liability on each of the transactions but excluding the other and whichever calculation gives the highest liability will be that used to determine the IHT due.

Calculation 1 – charge the GWR in death estate and ignore the CLT

	£
Value of free estate	2,710,000
Value of trust at death	<u>2,600,000</u>
	5,310,000
Less: NRB (N1)	<u>(231,000)</u>
	<u>5,079,000</u>
IHT at 40%	2,031,600
Less: lifetime tax on GWR (N2)	<u>(565,750)</u>
IHT due under calculation 1	<u>1,465,850</u>

(N1) NRB £325,000 - used on 2018 transfer (£100,000 - £3,000 - £3,000) = £231,000

(N2) Lifetime tax on GWR = IHT on set up

Calculation 2 – charge the CLT and ignore the GWR in the death estate

Transfer to trust May 2020

	£	£
Gross value (N1)		3,059,750
Less: NRB	325,000	
Used on 2018 transfer	<u>(94,000)</u>	
		<u>(231,000)</u>
		<u>2,828,750</u>
IHT at 40%		1,131,500
Less: Lifetime tax		<u>(565,750)</u>
IHT due on CLT		<u>565,750</u>

(N1) £2,494,000+£565,750

Death Estate

	£
Value excluding trust	<u>2,710,000</u>
IHT at 40%	<u>1,084,000</u>

Total IHT under calculation 2 = £565,750+£1,084,000 = **£1,649,750**

Therefore, the IHT due on Cora's death will be £1,649,750 as the computation (calculation 2) with the largest IHT liability will be chosen.

The trustees of the trust will be responsible for the payment of £565,750 and Cora's executors will be responsible for the payment of £1,084,000. Both amounts will be due on 31 January 2023 or date IHT account submitted if earlier.

The instalment option is available on the additional tax due on the CLT as it is property. The instalment option is also available on the £2.2m/£2.7m x £1,084,000 = £880,000 of the death tax. This can be paid in ten annual instalments starting on 31 January 2023. The balance of £204,000 will be due on the normal date.

MARKING GUIDE

TOPIC	MARKS
(a) IHT and CGT arising from setting up the trust, stating who is responsible for payment and when it is due.	
The Property Trust is settlor interested for CGT – s169F TCGA 1992	0.5
No holdover relief on creation despite IHT charge	0.5
Settlor interested for IHT; IHT on creation but also a GWR	1
CGT on set up = MV-cost-AE	0.5
CGT rate - residential property at 28%	0.5
Report and pay within 30 days (residential property)	0.5
CGT due on 9 June 2020.	0.5
IHT – Loss to estate less AE x 2	0.5
Deduct NRB and calc of NRB £231k	0.5
Tax grossed up at 20/80 as Cora paid IHT	0.5
IHT was due by Cora on 30 April 2021	0.5
subtotal	6
(b) IHT that will be charged on Cora’s death, who is responsible for payment and when it is due.	
GWR charged to IHT in death estate and also the CLT on same property also charged to IHT	0.5
Double Charges Regulations SI1987/1130 (regulation 5) apply	0.5
Two calculations - whichever gives the highest liability is used	0.5
Calculation 1 GWR in death estate –	0.5
Include Total estate (incl CGT liability)	0.5
NRB calculation	0.5
Tax at 40%	0.5
Less lifetime tax	0.5
Total IHT under calculation 1	
Calculation 2 CLT -	0.5
Gross value (from part (a)) plus IHT paid by Cora	0.5
Less NRB less value of 2018 gift less 2 x AE	0.5
At 40%	0.5
Less: lifetime tax	0.5
IHT due on CLT	
Calculation 2 - Death estate excluding GWR	
Add in Value excluding trust at 40%	0.5
Total IHT under calculation 2 = death tax on CLT+death tax on remainder of estate is higher	0.5
Trustees responsible for the payment of £565,750/Cora’s executors responsible for payment of £894,978	0.5
Both amounts due on 31 January 2023.	0.5
Instalment option available on additional CLT and death estate	0.5
Subtotal	9
Total	15

Question 4:

Executors' Tax liabilities and forms R185/R185 (estate)

1. Income Tax (notes):

The executors are chargeable to Income Tax at the basic rate of 20% for savings and non-savings income and 7.5% for dividends.

The ISA income continues to be treated as such until the earlier of three years from date of death, the date that the portfolio is sold/transferred by the executors or cessation of the administration period.

As there have been no residual income distributions or capital appointments during 2019/20 the Income Tax calculation for the executors can be calculated for both years together.

The specific legacy of Sleepy Hollow and contents is not income bearing so there is no R185 (estate) required for Rebecca.

Interest arose on the pecuniary legacy from the date of death in accordance with the terms of the Will. This is calculated as £60,000 @ 3% x 15/12 = £2,250. The legatee receives this interest gross.

This interest is not an allowable deduction for Income Tax but is deductible from the net residuary estate income thereby reducing the residual income of the estate to be transferred to the trust.

The trust income distribution made to Leah during 2020/21 is deemed to have been made after tax at the applicable estate rate of 20% as income distributions are deemed to be made from non-savings income in priority to savings income and dividend income.

The trust will be deemed to receive the balance of the residuary income at the end of the administration period.

Income Tax liability of executors':

Source	Gross Income
	£
Rents (£11,400 + £22,800)	34,200
Bank interest (£2,250 + £750)	3,000
Dividends - non-ISA (£600 + £1,200)	<u>1,800</u>
Total	<u><u>£39,000</u></u>

Income Tax:	£	£
@ 20%	37,200	7,440
@ 7.5%	<u>1,800</u>	<u>135</u>
	<u>£39,000</u>	<u>£7,575</u>

Distributable income (taxable):

	£	£	£	£
	Total	Rent	Interest	Dividend
Gross	39,000	34,200	3,000	1,800
Income Tax 20%/7.5%	(7,575)	(6,840)	(600)	(135)
Interest*	<u>(2,250)</u>	<u>(2,250)</u>		
Available for distribution	29,175	25,110	2,400	1,665
Less distribution to Leah	<u>(8,000)</u>	<u>(8,000)</u>		
Residue	<u>£21,175</u>	<u>£17,110</u>	<u>£2,400</u>	<u>£1,665</u>

*There is no prescribed order of set off, however estate administration expenses (in this case just interest on the pecuniary legacy) should be allocated in the most tax efficient manner. As the residue will be distributed to the trust these have been set against income that will be taxed at 45% (could be either non-savings or savings income) in priority to dividend income which will only be taxed at 38.1%.

N.B. Candidates will be awarded marks irrespective of their chosen order of set off.

R185 (estate) for Leah - distribution on 31 December 2020

2020/21	Total	Non-Savings
	£	£
Net income	8,000	8,000
Tax (x 20/80)	2,000	2,000

R185 (estate) for Trust – end of admin period on 5 April 2021

2020/21	Total	Non-Savings	Savings	Dividends
	£	£	£	£
Net income	21,175	17,110	2,400	1,665
Tax (x 20/80 / x 7.5/92.5)	5,013	4,278	600	135

2) Calculation of initial value of trust:

Initial Value of trust (capital):

	£
Total estate (net of liabilities (£20,000))	1,850,000
Less specific legacy	(500,000)
Less pecuniary legacy	(60,000)
Less IHT	<u>(360,000)</u>
	<u>£930,000</u>

3) Trustees' liability to income tax and form R185 (trust)

Income Tax – notes:

The ISA investment loses its tax-free status on the cessation of the admin period on 5 April 2021 and the income arising during 2021/22 is therefore taxable on the trustees.

The trust income distribution made to Rebecca in 2021/22 is deemed paid net of 45%.

Income tax liability of trustees' 2020/21:

Source	Gross Income	Tax deducted
	£	£
Non-savings	21,388	4,278
Savings	3,000	600
Dividend	1,800	135
Total	<u>£26,188</u>	<u>£5,013</u>
Income Tax:	£	£
@ 20%	1,000	200
@ 45%	23,388	10,525
@ 38.1%	<u>1,800</u>	<u>686</u>
	£26,188	11,411
Deducted at source		<u>(5,013)</u>
Payable 31 January 2022		<u>£6,398</u>

Payments on account for 2021/22 of £3,199 were each payable 31 January/July 2022.

Income tax liability of trustees' 2021/22:

Source	Gross Income	
	£	
Rents		22,800
Bank interest		300
Dividend inc. ex-ISA		<u>3,600</u>
Total income after expenses (nil)		<u><u>£26,700</u></u>
Income Tax:	£	£
@ 20%	1,000	200
@ 45%	22,100	9,945
@ 38.1%	<u>3,600</u>	<u>1,372</u>
	£26,700	11,517
Less previously due on account		<u>(6,398)</u>
Payable 31 January 2023		<u><u>£5,119</u></u>

R185 (Trust) Rebecca – distribution 31 October 2021

2021/22	Total	Rate applicable to trusts
	£	£
Net income	11,000	11,000
Tax x 45/55	9,000	9,000

MARKING GUIDE

TOPIC	MARKS
Estate:	
Executors' Income tax:	
Tax @ 20%/7.5% as appropriate	1
ISA income exclusion	0.5
Both years together – informal payment, no distributions during 2019/20	1.5
Distributable income – deduct executors' admin expenses (interest on pecuniary legacy)	1
Interest on pecuniary legacy paid gross, R185 N/A	1
R185 (estate) Leah – applicable rate 20% (non-savings income)	1
R185 (estate) trust – residue	2
Sub-total	8
Trust:	
Initial value: Total estate less Sleepy Hollow & contents, liabilities, IHT, pecuniary legacy	2
Trustees' Income Tax:	
ISA income no longer tax-free (2021/22)	0.5
Discretionary income distribution deemed tax credit 45%	0.5
2020/21 – trustees taxed on R185 (estate)	0.5
Taxable at rate applicable to trusts - basic rate, 45%, 38.1% as appropriate less TC	2
Payment due date/amount – balancing payment 2020/21	1
Payment due dates/amounts – POA 1&2 2021/22	1.5
2021/22 - taxable at rate applicable to trusts - basic rate, 45%, 38.1%	1.5
Less POA	0.5
Balancing payment & due date	1
R185 – Rebecca	1
Sub Total	10
TOTAL	20

Question 5:

1) Inheritance Tax liability on Tom's death:

Notes:

The estate has a partially exempt residue (qualifying political party)

The estate has a tax-free legacy – the gift of Windy Ridge and its contents to Mabel.

Double grossing therefore applies to the death estate.

The failed potentially exempt transfer (PET) to Harold only uses up part of Tom's nil rate band (NRB) of £325,000. The balance of Tom's NRB (£25,000) and the full transferable nil rate band (TNRB) from Tom's late wife June of £325,000 are both therefore available against the tax-free legacy to Mabel – a total of £350,000.

The residence nil rate band (RNRB) and transferrable nil rate band (TRNRB) are not available against the gift to Mabel as she is not Tom's direct lineal descendent.

Tax due on death estate:

Double Grossing calculations:

Step 1 - Gross up tax-free legacy (single gross):

	£	£
Assumed chargeable estate		450,000
NRB (above)	25,000	
TNRB (above)	325,000	
NRB/TNRB utilised	<u>(350,000)</u>	
NRB/TNRB c/f	£0	<u>(350,000)</u>
Chargeable		<u><u>£100,000</u></u>
IHT @ 40% x 100/60		<u>£66,667</u>
Gross Legacy (£450,000 + £66,667)		<u><u>£516,667</u></u>

Step 2 - Chargeable value of the estate and notional tax thereon:

		£
Total net estate		1,635,000
Less gross legacy		<u>(516,667)</u>
Residue		<u>£1,118,333</u>
50% chargeable to tax		<u>£559,167</u>
Taxable estate	£	£
(£516,667 + £559,167)		1,075,834
NRB (£25,000)	25,000	
TNRB (£325,000)	325,000	
NRB/TNRB utilised	<u>(350,000)</u>	
NRB c/f	£0	<u>(350,000)</u>
Chargeable		<u>£725,834</u>

IHT @ 40% (notional) £290,334

Step 3 - Estate rate:

Estate rate $(£290,334/£1,075,834 \times 100)$ 26.9869%

Step 4 - Gross up tax-free legacy (single gross) using estate rate (Step 3):

$£450,000 \times 100/(100-26.9869)$ £616,328

Step 5 - Chargeable value of the estate and actual tax thereon:

		£
Total net estate		1,635,000
Less gross legacy		<u>(616,328)</u>
Residue		<u>£1,018,672</u>
50% chargeable to tax		<u>£509,336</u>
Taxable estate	£	£
(£616,328 + £509,336)		1,125,664
NRB	25,000	
TNRB	325,000	
NRB/TNRB utilised	<u>(350,000)</u>	
NRB c/f	0	<u>(350,000)</u>
Chargeable		<u>£775,664</u>
IHT @ 40% (actual)		<u>£310,266</u>

Step 6 – Recalculate estate rate and show estate distribution:

Estate rate ($\frac{£310,266}{£1,125,664} \times 100$)	<u>27.5629%</u>
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Tax on tax-free legacy to Mabel:

£616,328 x 27.5629%	<u>£169,878</u>
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Borne equally between chargeable and exempt residue

Tax on chargeable residue:

£509,336 x 27.5629% £140,388

Borne by chargeable residue

Distribution of estate:

£

Tax-free legacy to Mabel 450,000

Residue (£1,635,000 – £450,000 = £1,185,000)

50% residue to political party:

$((£1,185,000/2) - (£169,878/2)) = (£592,500 - £84,939)$ 507,561

50% residue to Harold:

$(£592,500 - £84,939 - £140,388)$ 367,173

IHT to HMRC (£169,878 + £140,388)

Payable by executors 31 December 2022 310,266

Total net estate £1,635,000

MARKING GUIDE

TOPIC	MARKS
IHT on lifetime transfers:	
Failed PET utilises part NRB. Full TNRB available. RNRB/TRNRB not available – residence to niece not direct lineal descendent	1.5
Death Estate:	
Identify double grossing appropriate – conditions tax-free legacy, partially exempt residue	1
Step 1 – single grossing tax free legacy, balance NRB, TNRB, IHT x 40/60, gross value of tax-free legacy	2
Step 2 – chargeable value estate – calculate chargeable residue	1
Step 2 – Notional tax thereon - chargeable estate, NRB/TNRB, IHT @ 40%	1
Step 3 – estate rate	0.5
Step 4 – single grossing tax free legacy using estate rate	1
Step 5 – chargeable value estate using adjusted gross value of tax-free legacy	1
Step 5 – actual tax thereon	1
Step 6:	
Recalculation of estate rate	1
IHT on tax-free legacy to Mabel, borne by whom	1
IHT on chargeable residue, borne by whom	1
Subtotal	13
Distribution of estate, Mabel, The Conservative Party, Harold, Total IHT (inc due date)	2
Subtotal	2
TOTAL	15

Question 6:

Tax consequences of winding up the trust pre or post sale of the car park

Notes:

Jubaila – Life Interest

The distribution to Jubaila of the family home will have no Inheritance Tax (IHT) consequences – it was an immediate post death interest and therefore a qualifying interest in possession forming part of her estate and continues to be included as part of her estate after distribution. This is the case irrespective of the date of transfer. Although created on the same day it is not relevant property for the purposes of calculating any exit charge on the Badem Discretionary Will Trust.

For Capital Gains Tax (CGT) purposes Jubaila has resided in the property as her main residence since Ahmet's death and so full private residence relief (PRR) is available to negate any gain arising, again irrespective of the date of transfer. This will need to be formally claimed by the trustees via the self-assessment trust tax return.

Cahil and Yusef – The Badem Discretionary Will Trust

Distribution of residual assets before 31 December 2022:

Any distribution of the residual assets before 31 December 2022 will be related back to the date of death for IHT under s.144 IHTA 1984.

As the distribution will also take place before the estate is fully administered and the residue passed to the trustees of the Badem Discretionary Will Trust, assets will pass to the trust beneficiaries at probate value for CGT purposes.

Cahil - CGT

Cahil will acquire the car park at its probate value i.e., £10,000.

On sale of the car park by Cahil, CGT will be payable as follows:

	£
Expected proceeds	180,000
Less costs of sale	(5,000)
Less probate value	<u>(10,000)</u>
Net Gain	165,000
Annual exemption	<u>(12,300)</u>
Chargeable gain	<u>£152,700</u>
	£
CGT @ 10% (£50,270 – £21,000) = £29,270	2,927
CGT @ 20% (£152,700 - £29,270 = £123,430	<u>24,686</u>
Total CGT payable 31 January 2024	<u>£27,613</u>

Sale by trustees in April 2023 followed by the distribution of trust assets:

CGT

On sale of the car park by the trustees CGT will be payable as follows:

	£
Net Gain (as above)	165,000
Annual exemption (two trusts created by settlor)	<u>(3,075)</u>
Chargeable gain	<u>£161,925</u>
	£
CGT @ 20% payable 31 January 2024	<u>£32,385</u>

Cahil will receive the net proceeds of the sale of the car park (after costs of sale and CGT payable by the trustees) free of CGT as cash is not a chargeable asset.

Yusef will receive the jewellery free of CGT as the jewellery falls within the chattel exemption.

A total capital gain of £15,000 arises on the shop and flat but this can be held over by joint election of the trustees and Yusef under s.260 TCGA 1992 as there is an IHT liability arising on the trust (see below). Yusef effectively receives these assets at probate value as the gain is deducted from the market value to arrive at his base cost for CGT going forward.

Alternatively, the trustees can pay CGT at 20% on the shop i.e., £5,000 @ 20% = £1,000 and CGT @ 28% on the flat i.e., £10,000 @ 28% = £2,800 in which case Yusef's base cost for future disposals would then be the current market value.

In either case, the proportionate IHT payable on the exit from the trust can be added to the base cost of the assets passed to Yusef (s.260(7) TCGA 1992).

N.B. If choosing to pay the CGT, the trustees should claim the annual exemption against the flat instead of the car park as this incurs the highest rate of CGT.

IHT

As the sale of the car park will take place after 31 December 2022, the distribution from the trust will fall outside the two years following Ahmet's death and the trust beneficiaries will therefore no longer benefit from the reading back under s.144 IHTA 1984.

An IHT exit charge will therefore arise on the distribution as follows:

Exit charge

		£	£
Initial value of relevant property	A		530,000
Initial value of relevant property in a related settlement	B		0
Total (A+B)	C		530,000
NRB at date of exit	D	325,000	
Less: Settlor's chargeable transfers in seven years prior to settlement	(E)	(0)	
NRB remaining	(F)		(325,000)
Notional transfer (C –D)	G		205,000
Notional Tax (G x 20%)	NT		41,000
Effective rate (NT/C x 100)	ER%		7.736%
Actual rate ((ER x 30%) x n/40), n = 9	AR%		0.522%
Exit charge = ("loss to trust*" x AR)	EC		£3,589

*The loss to trust will be the total value of the assets less the CGT incurred by the trustees on sale of the car park i.e., £200,000 + £60,000 + £180,000 + £105,000 + £180,000 - £5,000 - £32,385) = £687,615.

The above calculation assumes that the trustees and Yusef will jointly elect for holdover relief under s.260 TCGA 1992 to apply to the distribution of the shop and flat. If the trustees choose to pay the CGT on the distribution of the shop and flat this will reduce the loss to the trust and the exit charge accordingly.

It is more beneficial to distribute the assets comprising the residue before 31 December 2022 and before the estate has been fully administered, however it does not matter when the family home passes to Jubaila.

MARKING GUIDE

TOPIC	MARKS
IPDI – no IHT QIIP to LT/no CGT (100% PRR) irrespective of timing	1.5
QIIP therefore not relevant property for exit charge calculation BDWT	0.5
Immediate distribution:	
IHT – S.144 applies so no IHT within 2 years	0.5
CGT – inherit at probate value, estate still being administered	0.5
CGT – Cahil computation - POS, AE, I rates of tax (basic and higher rate taking income into account)	2
Distribution after sale of car park	
CGT car park – trustees’ computation – trust AE (1/2) & CGT rate	1
CGT other:	
Cash N/A,	0.5
Jewellery exempt,	0.5
Shop and flat total £15K @ 20/28% / s.260 applies	1.5
IHT interaction	0.5
AE reallocation against flat	0.5
IHT – exit charge calculation – initial value (probate after IHT), no related property (PAG above), NRB, no cumulative chargeable transfers	1.5
IHT – NT, ER, AR	2
IHT – “loss to trust” MV less COS, CGT @ AR	2
TOTAL	15