Chartered Institute of Taxation
Excellence in Taxation

The Chartered Tax Adviser Examination

May 2018

Inheritance Tax, Trusts & Estates

Advisory Paper

TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing.
- You should answer all **SIX** questions.
- Start each answer on a fresh page and do not write in the margins.
- 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 any 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 booklet.
- Unless otherwise indicated by the provision of additional table information, you may assume that 2017/18 rates and allowances continue to apply for 2018/19 and future years. Candidates referring to actual or pending rates and allowances for 2018/19 and future years will not be penalised.

1. You are a tax manager in a firm of Chartered Tax Advisers and have been asked for advice by Scott Linden, the Personal Representative and sole beneficiary of the estate of his father, Joseph Linden, who died on 14 January 2018. In a recent meeting with Scott you were provided with the following information:

The personal estate of Joseph Linden comprised of:

	£
Freehold property – joint tenancy (Scottish law: joint ownership) with son (value of half share)	300,000
Investments	200,000
Cash	125,000

Joseph was also the life tenant of the Linden Family 1986 Trust. This was created by Joseph's late father for the benefit of Joseph for life passing on his death to Joseph's niece Amy as remainderman. The trust's sole asset is a property worth £500,000 at the time of Joseph's death, which was used throughout as Joseph's main residence as permitted under the terms of the trust.

In June 2008, Joseph gifted a holiday cottage to Scott and its value at that time was £80,000. Joseph continued to use the cottage for at least 20 weeks per year but did not make any payment for that use. At the date of Joseph's death the cottage was valued at £100,000. Joseph had made no other gifts prior to his death.

Shortly before he died Joseph expressed a wish to Scott that he would like to make some charitable donations. Unfortunately, his Will was not updated to provide for this but Scott is keen to fulfil his father's last wish and maximise the tax relief available. He has requested advice on how this could be achieved and the tax implications arising.

There is no transferable nil rate band available from Joseph's late wife.

You are required to write a letter to Scott advising him of the potential Inheritance Tax liability arising by reason of his father's death, by whom this is payable and when, and including a response to Scott's question regarding his father's wish.

(15)

2. Genea Cooper has requested a meeting to discuss tax planning for herself and her husband, who are both UK resident and domiciled. They have one child, James, who is six years old.

In 2017/18 Genea received the following taxable income:

	£	
Salary	90,000	
Rental profits (three properties)	35,000	(no mortgage)

The property portfolio is currently valued at £415,000. The original costs and capital expenditure on the properties total £220,000.

Her husband, Philip, does voluntary work for a charity and has no taxable income of his own.

Genea has decided that she would like to gift her rental property portfolio to an interest in possession or discretionary trust for the benefit of Philip and/or James and she wishes to understand the tax implications.

You are required to prepare notes in advance of your meeting:

1) Setting out the Income Tax, Capital Gains Tax and Inheritance Tax implications of Genea's decision. (10)

2) Considering any alternative options and the tax impact thereof. (5)

Total (15)

3. You are the tax manager in a firm of Chartered Tax Advisers and are responsible for the knowledge management of the tax team.

Several members of the team, whilst having sound technical knowledge, periodically request training sessions on certain subjects in which they feel they are lacking or where they have taken on new work which requires them to hone their knowledge in a particular area.

This month the chosen topic is trusts for the disabled and in response to a questionnaire, the team has requested more information on the following:

1) The reasons for setting up a trust for the disabled.

2) Who is able to set up such a trust.

3) The definition of a disabled person for this purpose.

4) The qualifying conditions that the trust must meet for Income Tax, Capital Gains Tax and Inheritance Tax.

5) The qualifying conditions that the beneficiary/beneficiaries must meet for Income Tax, Capital Gains Tax and Inheritance Tax.

6) The Income Tax, Capital Gains Tax and Inheritance Tax treatment of such a trust.

You are required to prepare notes for an internal training presentation to the personal tax team covering each of the specific aspects raised in relation to trusts for the disabled. (15)

4. On 14 May 2003 Freda Kebby created the Kebby 2003 Trust, for the maintenance, education and benefit of her grandchildren. The terms of the trust provide for income at age 23 and capital entitlement at age 28. Freda had not made any other lifetime gifts prior to creation of the trust or created any other settlements.

Freda's grandchildren and their dates of birth are:

Hollie	18 January 1988
Victoria	4 July 1990
Louise	12 September 1997

The assets settled in the trust and valuations over time are as follows:

	14 May 2003	14 May 2013	18 Jan 2016	4 July 2018 (estimated)
	£	£	£	£
Freehold property	250,000	400,000	450,000	325,000
Investment portfolio	150,000	200,000	225,000	160,000
Cash	50,000	75,000	50,000	25,000

Notes

1) No disposals have been made from the investment portfolio since the creation of the trust.

2) The Inheritance Tax rate at the last 10 year anniversary in May 2013 was 3.111%.

The trustees did not seek advice at the time of the appointment of Hollie's share on her 28th birthday and have calculated and paid Capital Gains Tax on the land and shares without making any claims. They did not take any action in respect of Inheritance Tax at the time and are keen to know what the consequences are.

The trustees have requested your advice on the Inheritance Tax and Capital Gains Tax implications of the appointment of Victoria's share of the capital on her forthcoming 28th birthday particularly as they are aware that Victoria is considering taking a post-graduate study position in Australia for a minimum of five years. Victoria has requested that her share of the investment portfolio is transferred to her in specie as was done for Hollie.

The trustees are particularly interested in receiving information about any deferral reliefs available and the impact of any claims on the beneficiaries.

You are required to write a report for the trustees:

1) Explaining the Capital Gains Tax and Inheritance Tax implications of the appointment of Victoria's share of the trust assets, including calculations of the liabilities arising and stating the trustees' responsibilities with regards to the reporting and payment of the same. (14)

2) Advising them on any actions which they should take in relation to the appointment of Hollie's share and quantifying any tax liabilities arising. (6)

Total (20)

You are <u>NOT</u> required to calculate interest or penalties.

5. Chris Holt, a partner in the Holt farming partnership, died on 2 May 2017. He had moved into a nursing home some 15 months earlier but had remained a partner and continued to be consulted on partnership decisions by the two other partners, his son David and David's son, Michael. His widow, Angela, who is the executor, has requested that you calculate the Inheritance Tax due on his estate (which is already late) and submit the IHT400 before 31 May 2018.

Chris, who utilised his annual exemption on 6 April each year, also made the following gifts:

<u>5 September 2011</u>
49% of the shares in the family contracting company, Holt Contracting Ltd, to a discretionary trust for David and his issue. At the time of gift the shares were valued at £700,000 and 100% Business Property Relief was claimed. The trust was wound up in favour of David on 5 April 2015.

<u>7 April 2012</u>
50 acres of farmland to David when David joined the partnership. At that time the land had an agricultural value of £500,000 but no market value premium. On 5 April 2015 David gifted his 50 acres to Michael when he joined the partnership.

<u>30 April 2012</u>
The farmhouse (jointly with Angela) to David when it was valued at £200,000. Chris and Angela moved into a barn conversion next door ("The Barn"). David continues to live in the farmhouse with his son Michael and it remains the hub of the farming activity.

Chris left his entire free estate to David. His estate comprised the following assets:

	£
A 26% shareholding in Holt Contracting Ltd (Note 1)	400,000
A 50% share in The Barn (Note 2)	144,000
50 acres of farmland (Note 3)	550,000
Cash and personal chattels	185,000
His partnership share	200,000

<u>Note 1</u>
Angela owned the remaining 25% shareholding in Holt Contracting Ltd. The combined 51% shareholding was valued at £1.53 million. No excepted assets were identified.

<u>Note 2</u>
The Barn was valued at £320,000 as a whole (Chris held as joint tenant with Angela (Scottish law: joint ownership with survivorship)).

<u>Note 3</u>
The value is the agricultural value of the 50 acres. Five acres of this land has planning permission for development and was valued at £2 million. The land continued to be used for farming to the date of Chris's death and there were no existing arrangements in place for sale at that time. The executors have since received an offer of £1.8 million for the five acre plot and plan to proceed with the sale as soon as probate is obtained.

Michael wants to purchase the rest of the land from the executors for £540,000, and the contracting company shareholding for £403,000.

You are required to:

1) **Calculate the Inheritance Tax payable on Chris Holt's death, and state by whom this is payable. No calculation of interest is necessary.** (12)

2) **Explain the post mortem reliefs that may be available to the executors, detailing the conditions for relief and the time limits for any claims. You are <u>NOT</u> required to calculate the relief due.** (8)

Total (20)

6. The Hegarty Discretionary Settlement was created on 1 April 2008 by Emily Hegarty, a higher rate taxpayer, who has always been UK resident and domiciled. She has not made any other settlements but in 2006 she had made a chargeable lifetime transfer to the family company of £100,000.

The beneficiaries of the settlement are Emily's two daughters, Julie, born 31 March 1997 and Charlotte, born 15 September 1999. Both Julie and Charlotte are still in full time education and have no independent sources of income.

The initial value settled was cash of £275,000 and Emily paid the Inheritance Tax due. £50,000 of that initial cash was placed in the trust current account and the balance was invested in a portfolio of stocks and shares which has paid regular interest and dividends. The income has been paid to the trust current account and is reflected in the undistributed income account shown in the trust balance sheet. The trustees have no obligation to accumulate income and have not done so.

On 23 May 2015, Emily added £150,000 to the settlement and paid the Inheritance Tax due. The addition was immediately used to purchase a rental property which was already tenanted and this has produced rental income throughout (again reflected in the undistributed income account shown in the trust balance sheet).

The trust income (net of tax paid), added to the current account each year, was as follows:

	£	
2008/09	7,220	
2009/10	7,220	
2010/11	6,240	
2011/12	6,240	
2012/13	6,240	(no income was received between 1 and 5 April 2013)
2013/14	6,730	
2014/15	6,730	
2015/16	10,305	
2016/17	10,977	

For 2017/18 the trust income was as follows:

	£	Tax £
Rental income	7,800	
Unit trust Interest	3,600	720
Dividends	7,200	

The tax pool brought forward at 6 April 2017 was £38,658.

Capital distributions of £25,000 were made to each of the beneficiaries on their respective 18th birthdays and the beneficiaries paid any Inheritance Tax (IHT) due.

As at 1 April 2018, the share portfolio was valued at £330,000 and the rental property at £160,000.

You are required to:

1) **State the optimum amount(s), date(s) and recipient(s) of the income distribution(s) for 2017/18 to minimise both Income Tax and Inheritance Tax; show the R185 entries for Julie and Charlotte; and prepare a calculation of the tax pool balance as at 6 April 2018.** (7)

2) **Calculate the trust's 10 year anniversary charge on 1 April 2018 assuming that the optimum amount of income has been distributed.** (8)

Total (15)