The Chartered Tax Adviser Examination

May 2017

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 and annotate your question paper. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing. Calculators may not be used during this time.
- 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 2016/17 rates and allowances continue to apply for 2017/18 and future years. Candidates referring to actual or pending rates and allowances for 2017/18 and future years will not be penalised.

1. Trevor Kerr (UK domiciled) died on 1 February 2015 aged 85 leaving the following net estate:

	£
His residence "The Gables"	580,000
Cash in bank	100,000
A rental property	165,000
Share portfolio	120,000
Total net estate	£965,000

Under his Will he left 3/4 of the residuary estate to his daughter, Vicky, as a thank you for looking after him in his declining years (she is unmarried and had lived with her father in The Gables as his carer since the death of his wife in 1995). Vicky continued to live in The Gables until 31 July 2015.

The remaining 1/4 of his residuary estate was left to his son Tom, who is married with three children.

The rental property was appropriated to Vicky on 31 July 2015 immediately after the tenant moved out. The property was worth £180,000 at that time. Vicky immediately moved into the property as her main residence.

The share portfolio was sold on 5 April 2016 for £135,000.

After Vicky moved out of The Gables the executors advertised it for let. It was let for six months from December 2015 and thereafter remained unoccupied until it was sold for £650,000 on 18 December 2016. Costs of sale comprised agents' fees of £8,125 and legal costs of £3,150.

The estate administration period ended on 15 February 2017 and the balance of the estate was paid out to Vicky and Tom on 30 April 2017 in accordance with their respective shares of residue.

The following estate income was received by the executors during the administration period:

Tax Year	2014/15	2015/16	2016/17
	£	£	£
Interest (gross)	0	0	1,340
Interest (net)	400	160	0
Rents	1,300	7,800	2,600
Dividends (net)	900	1,800	0
Administrative expenses	(1,000)	(2,000)	(800)

There was no accrued income charged to Inheritance Tax on the death estate.

The executors have received notifications to file self-assessment returns.

You are required to:

1) **Calculate the executors' Income Tax and Capital Gains Tax liabilities for 2014/15, 2015/16 and 2016/17 showing the due dates for payment and the residuary income available for distribution.** (11)

2) **State the R185 entries for Vicky and Tom.** (4)

Total (15)

Ignore any possible liability to interest and penalties.

2. Your firm's Tax Partner has just heard that his good friend Harold Hardy, a widower and longstanding UK domiciled client of the firm, died unexpectedly on 1 March 2017.

Harold inherited his UK domiciled wife's entire estate on her death in 2009 (she had made no lifetime gifts in the previous seven years) and he subsequently made considerable efforts to reduce his enlarged estate by making the following gifts:

01/04/2011	£150,000 to Stan (his eldest child) to assist with his new house purchase.
31/07/2011	£150,000 to Molly (his youngest) to fund her Master's degree.
15/08/2012	Establishment of a discretionary trust for his grandchildren. The initial value transferred was £800,000. Harold made no gifts in the seven years prior to the initial transfer other than those in 2011 above and the trustees paid the entry charge. Harold paid the accountancy fee for the trust each year.
01/01/2014	£150,000 to Heather (his eldest daughter) on her marriage.
31/12/2016	£10,000 each to Stan, Molly and Heather.

His net annual income was £180,000 of which he used approximately £150,000 each year leaving annual surplus income of approximately £30,000.

The Tax Partner recalls that some years ago Harold inherited a painting from his uncle on which no Inheritance Tax was paid, it being conditionally exempted as National Heritage Property. At the time Harold had given an undertaking to make the painting available to a local gallery for three months of every year and had done so throughout his ownership, during which time the painting has significantly increased in value. The painting will pass directly to Stan, who is also the sole executor and the remainder of his estate will be split equally between Harold's three children.

Stan has arranged a meeting with the Tax Partner next week and wishes to discuss the liability to Inheritance Tax arising on his father's death. He has provided the following additional information in respect of his father's estate:

1) His residence has been valued at £700,000.
2) The painting has been valued at £500,000.
3) He had cash in the bank of approximately £500,000.
4) The funeral will cost approximately £10,000.

Stan, as the recipient of the painting, is particularly interested to understand his obligations if the Conditional Exemption is to be preserved following Harold's death. He would also like to know his future options in respect of the painting and the Inheritance Tax effect of each.

The Tax Partner has not come across the Inheritance Tax Conditional Exemption for National Heritage Property previously.

You are required to:

1) **Prepare draft Inheritance Tax computations for discussion at the meeting assuming that Conditional Exemption applies to the painting.** (10)

2) **Draft a memo to assist the Tax Partner in his discussions with Stan about Conditional Exemption. This should refer to the conditions for the relief, the claims procedure, replacement undertakings and loss of exemption, highlighting how these could apply to Stan.** (10)

Total (20)

3. You are a tax manager in a firm of Chartered Tax Advisers. Rebecca Smith (UK resident and domiciled) is a new client who has just received a diagnosis of breast cancer and she is keen to put her affairs in order. In 2010 she made gifts to her adult children and she would like advice from you on the tax position.

In April 2010 she gave her holiday cottage in Wales and its contents (none of which were of any significant value) to her son Matthew. The property was then worth £280,000. Rebecca continues to have unlimited use of the property. The current value of the property is £320,000 and market value rent for the property as residential accommodation is £800 per month.

In September 2010 she sold her London home for £1 million and moved to the Midlands to be closer to her daughters Mandy and Karen who live in Shropshire and Derbyshire respectively. Her new residence cost £450,000 and has not changed in value. She used the balance of the proceeds to give each of her daughters £275,000.

Mandy sold her old house for £325,000 and used the net proceeds together with the cash gift from Rebecca to purchase a new bungalow to increase the downstairs accommodation available for her son who suffered an accident leaving him partially paralysed. The current market value of the bungalow is £600,000 and it has a rental value of £1,200 per month.

Karen sold her old house for £450,000 and used the net proceeds together with the cash gift from Rebecca to buy a new house with more space for her third child who had just been born. The current market value of her new house is £725,000 and it has rental value of £1,500 per month.

Rebecca divides her time living between her own residence, those of her daughters and the holiday cottage in Wales. She provides respite for Mandy's son so that Mandy and her husband can go on holiday with their daughter twice a year (four weeks in total). She spends the school holidays (10 weeks a year in total) at Karen's looking after her children as Karen is a single mum and works full time. She also likes to spend some quiet time at the cottage in the autumn and visits for the odd weekend during the remainder of the year.

Rebecca has not been coping very well with her illness and Karen has invited her to live with her during treatment. Rebecca has agreed and will let out her own residence in the meantime.

Rebecca, who never married, receives a state pension and an annuity which ceases on her death. She has made no other gifts during her lifetime other than to fully utilise her annual exemption each year. Rebecca has no life insurance cover and on her death her assets, which comprise her home and cash of £250,000, will pass equally to her three children.

You are required to write a letter to Rebecca providing relevant explanations and advice in relation to the tax treatment of the gifts, supported by calculations where appropriate. (15)

4. You are a tax manager in a firm of Chartered Tax Advisers and one of your clients, Simon Baker, has recently approached you for advice.

Simon, who is divorced, has recently been diagnosed with Alzheimer's disease. He currently has capacity to make decisions on his financial affairs but he has been told his condition will deteriorate significantly over the next five to 10 years such that he will no longer have that capacity.

Simon has two children: William who is 21 and has Down's syndrome, and Charles who is 18 and has a degenerative illness that currently causes him no problems, but which is likely to worsen so that he will qualify for disability living allowance at the middle rate in eight to 12 years' time but not before then.

Simon is the life tenant of an Immediate Post Death Interest trust which contains as its sole asset a house which he intends to live in for the rest of his life. The house is worth £700,000. On his death this passes under the terms of the trust to his younger brother.

In addition Simon has a personal estate of approximately £1.5 million and would like your advice on the tax consequences of settling assets on trusts for himself and his children whilst he is still capable of managing his affairs. In the most part this is driven by the fact that he, William and Charles are likely to require trustees to administer assets on their behalf, however Simon is also interested in the tax consequences and benefits of trusts. Simon estimates he personally will need to spend £300,000 of his capital during the remainder of his life.

You are required to draft a letter to Simon explaining his options (involving trusts or otherwise) and the Inheritance Tax consequences of the current situation and the proposed transactions during his lifetime and on his death. Detailed calculations are NOT required. (20)

5. You are a tax manager in a firm of Chartered Tax Advisers. Your partner has asked you to deliver training on the concept of domicile addressing the meaning of domicile, how a domicile can be changed, deemed domicile, and how the use of offshore trusts created during lifetime can be used to plan for non-UK domiciliary clients.

After an initial introduction to the concept, you should cover the following examples in the training:

1) An individual who has a UK domicile of origin but who is emigrating abroad permanently.

2) An individual who has a UK domicile of origin, emigrated to Australia, displacing their domicile of origin, but who is now temporarily resident in France, having decided that they no longer wish to live in Australia or the UK, but do not wish to live in France permanently.

3) A trust settled with non-UK assets before the settlor became deemed domiciled in the UK compared to one settled after they became deemed domicile in the UK.

You are required to draft training notes that you will use during the session. (10)

6. Your client, Rosemary Jones, died on 8 March 2017. Rosemary had never married and left her entire estate to her sister Jennifer. At death her net estate comprised the following assets:

   1) Her house valued at £700,000.

   2) Cash in a bank account of £50,000 (no accrued interest).

   3) A second property valued at £350,000 if sold with vacant possession but currently let out to a third party on a lease with five years left to run.

   4) A painting valued at £20,000 which she inherited from her brother Paul on his death three years and two months ago when its value was the same. Rosemary paid the Inheritance Tax due on it of £6,000.

   5) A plot of agricultural land valued at £100,000. This had been farmed by Rosemary for eight years until 18 months before her death, at which point she ceased to farm the land and started to use it in her existing garden centre business.

   6) Her garden centre business, which she ran as a sole trader for 10 years before her death, valued at £250,000, excluding the land mentioned above.

   7) 100% of X Ltd, a company worth £300,000 and owned for five years before her death. X Ltd has rental properties which produce 75% of its income, with the balance of the income coming from a small trading business.

   Rosemary had made the following gifts in the 10 years before her death:

   1) On 3 April 2014 she gave £300,000 to her niece Ruth.

   2) On 2 March 2015 she gave shares worth £60,000 in an AIM listed trading company, Z Ltd, to her nephew John. She had held the shares for five years. The shares, which listed on the London Stock Exchange in March 2016, are still held by John.

   3) On 6 June 2015 she gave shares in an unquoted trading company Y Ltd to John. She had owned the shares for three years and they were valued at £100,000 at the date of the gift. John sold half of the shares in June 2016 for £60,000, of which £30,000 was reinvested in agricultural land rented out to a local farmer. This land and the remaining shares are still owned by John.

   4) On 9 September 2015 she established a discretionary trust for her nieces and nephews. She settled £50,000 cash and shares qualifying for 100% business property relief worth £200,000. All the shares were sold on 2 January 2016. The trust then purchased shares in an AIM listed trading company for £80,000 on March 2016, utilising 35% of the proceeds of the sale in January 2016.

   5) On 10 December 2015 X Ltd sold a house to John for £200,000 when the market value of the property was £250,000.

   6) On 20 December 2015 Rosemary gave shares in an unquoted trading company, W Ltd, worth £100,000, to her brother Max. She had owned the shares for three years and Max held the shares until his death in December 2016. Max's estate was below the available nil rate band and passed to their sister Jennifer (the beneficiary of Rosemary's estate). Jennifer has since sold the shares.

   You are required to calculate the Inheritance Tax due as a result of Rosemary's death, and state who should bear the tax. (20)