The Chartered Institute of Taxation

Advanced Technical

Inheritance Tax, Trusts & Estates

May 2021

Suggested answers

ANSWER 1

Trustees

Where an individual is neither UK resident nor domiciled at the time of trust creation, that trust would only become UK resident if all the trustees are UK resident. Therefore, whilst Fiona's non-UK resident brother continues to be a trustee the trust would remain non-UK resident for UK tax purposes.

As Fiona is included within the class of beneficiaries the trust is "settlor interested" for income tax purposes. Currently Fiona is non-UK resident and as a consequence the trust is not subject to income tax (IT) on the UK source income due to the nature of this income (i.e. disregarded income). However, once she becomes UK resident, the trustees would be subject to IT on all UK source income. The trustees would need to register with the Trust Registration Service and UK trust tax returns would be required whilst she is UK resident. The trustees would be liable to tax at 7.5% on the first £1,000 of dividend income and thereafter 38.1%. The trustees would qualify for a notional 7.5% tax credit on dividends as they are not UK resident. The trustees should provide Fiona, as settlor, with details of the UK source income and the tax paid (but not the 7.5% notional tax credit) on form R185.

The trustees would not be liable to UK Capital Gains Tax (CGT) unless the trust should acquire UK residential or commercial property.

The trustees would be liable to Inheritance Tax (IHT) on the value of the trust assets on each ten year anniversary of the trust's creation (next charge on 1 March 2023). The charge would be levied on UK situs assets for the total period held within the trust and on foreign situs property for the period 6 April 2022 to 1 March 2023. The rate of IHT is up to 6% of the market value of the assets held in trust on the day before the ten-year anniversary.

Fiona's tax position

As Fiona was born in the UK to UK domiciled parents she has a UK domicile of origin. On her return to the UK she would be regarded as a "formerly domiciled resident".

As the trust is settlor interested for income tax purposes, the worldwide income arising in the trust would be taxable on Fiona whilst she is UK resident. A credit would be available for the UK tax paid by the trustees. Fiona would have the right to be reimbursed by the trustees for the tax she pays on that trust income.

The trust would also be settlor interested for CGT purposes so Fiona would therefore be taxable on all trust capital gains but again there would be a right to reimbursement. The CGT definition of "settlor interested" for a non-UK resident trust is wider than for IT and applies where Fiona <u>or</u> her children are beneficiaries.

If Fiona fails to exercise her right to reimbursement this could arguably be regarded as an addition of funds to the trust and therefore she should exercise this right to avoid creating additional tax liabilities for her or the trustees.

For IHT purposes, the trust would continue to be treated as an "excluded property trust" in Fiona's first tax year of UK residence. As a consequence, all non-UK situs assets held in the trust would be outside her estate but UK situs assets would be subject to IHT on her death. Situs is usually determined by the location of assets or, in the case of shares, where they are registered or listed.

From 6 April 2022 should Fiona die whilst UK resident the value of the trust assets (both UK and offshore) would be included in her estate for IHT purposes. IHT is payable at 40% on the value in excess of her available nil rate band (currently £325,000).

Once Fiona leaves the UK and becomes non-UK resident again her liability to Income tax and CGT will cease and foreign assets would be outside the scope of IHT.

Recommendations

If Fiona does not intend to benefit from the trust she could consider being removed as a beneficiary before she becomes UK resident. The trust would not then be regarded as settlor interested for IT or IHT purposes. Fiona would not be required to pay IT on the trust income and the trust assets would not form part of her estate for IHT purposes.

The trustees would not be liable to UK tax on UK source income provided none of the beneficiaries were UK resident.

The Trust would remain settlor interested for CGT purposes as Fiona's children are within the beneficiary class. Fiona would therefore remain taxable on capital gains on the sale of any trust assets and for that reason may wish to delay any sales until she is no longer UK resident.

The IHT ten yearly charges would still arise on UK situs assets because these assets would be regarded as relevant property. The charge in March 2023 would be reduced if the UK situs assets could be sold prior to this and ideally prior to Fiona becoming UK resident.

MARKING GUIDE

TOPIC	**MARKS**
Trust	
Trust residency rules	1
Trustees reporting obligations due to UK situs assets	1
Trust tax rates	0.5
Tax credit on UK divs	0.5
No CGT payable by trustees	0.5
IHT 10 year charge approaching	0.5
10 year charge calculation and apportionment for period of relevant property and UK situs assets	1
Fiona	
FDR	0.5
Trust settlor interested income tax	0.5
Taxable on worldwide trust income/credit for UK tax suffered by trustees	1.0
Right to reimbursement from trustees	0.5
Settlor interest capital gains- description	1.0
Taxable on worldwide capital gains	0.5
Right to reimbursement- should exercise	0.5
IHT position first year`	1
IHT position after second year	1
UK tax liability once non-UK resident again	0.5
Recommendations	
Remove Fiona from benefitting and Income tax/IHT implications	1
Remain settlor interested for CGT	0.5
Sell the UK situs assets and timing	1
PHS	0.5
TOTAL	**15**

ANSWER 2

The tax implications of using the proceeds of the sale of Farida's business to create a trust to protect her assets in the future given her recent diagnosis are as follows:

For Inheritance Tax (IHT) purposes, Farida may self-settle funds onto a trust at a time when she has a condition which is reasonably expected to lead to her meeting the qualification of a disabled person (DP) and secure the IHT benefits that apply to a Disabled Persons Trust.

In this context, a DP is defined as:

1) A person, who by reason of a mental illness within the meaning of the Mental Health Act 1983, is incapable of administering his/her property or managing his/her affairs; or

2) A person who qualifies under a "benefits test" i.e. is in receipt of or eligible for one of the following benefits:
    i) Increased disablement pension
    ii) Attendance allowance
    iii) Care component of disability living allowance (DLA) (highest or middle rate) or mobility component of DLA (higher rate)
    iv) Personal independence payment
    v) Armed forces independence payment

The trust type can be either discretionary or an interest in possession but the trust terms must specify that during Farida's lifetime no other beneficiary can benefit from the trust property subject to the de-minimis rule to benefit from the lower of £3,000 or 3% of the capital fund per annum.

The assets settled would not be classed as either a potentially exempt transfer or a chargeable lifetime transfer but would instead be treated as remaining within Farida's estate for IHT purposes.

For Income Tax purposes the trust is settlor interested and the income is ultimately assessed on Farida throughout even if she later satisfies the DP qualification: The trust declares and pays tax on the income in the normal way via the trust tax return at trust rate if discretionary/basic rate if an interest in possession; She must declare the trust income and claim a credit for the tax paid by the trust (as reported on form R185) on her self-assessment return. In the case of a discretionary trust, any tax refund/offset due to her on account of such income is repayable to the trustees.

After allowing the benefit of the trust annual exemption, Capital Gains Tax (CGT) is charged on realised trust gains at the trust rates. However, as Farida's condition worsens the trust may benefit (special treatment) from a vulnerable person's election by reason of the DP qualification. This would enable the trust to benefit from Farida's annual exemption and her marginal rate of CGT until it ceases to qualify i.e. in the year of her death. A joint irrevocable election (using form VPE1) would need to be made by Farida and the trustee(s) within 12 months of the normal filing date of the first trust return for which it is to have effect. A claim must be made on the trust tax return each year to give effect to the special treatment.

MARKING GUIDE

TOPIC	**MARKS**
PHS	0.5
Can be self-settled “in anticipation” of becoming a disabled person – IHT purposes only	0.5
Definition of a “disabled person”	1.0
Discretionary or IIP trust	1.0
Capital limits applied for other beneficiaries	0.5
IHT neutral	0.5
Settlor interest for IT – trust return & rates of tax, R185 (settlor), refund repaid to trustees	2.0
Vulnerable persons election for CGT when qualify as DP, normal rules beforehand, joint election, time limit	2.0
Effect of special tax treatment, annual claim via SA, not applicable year of death, HMRC to be informed	2.0
TOTAL	**10.0**

ANSWER 3

Discretionary Income

		Accrued income	S	D
		£	£	£
Bank Interest to 5/10			64	
Bank Interest from 6/10			33	
Dividends to 5/10				12,000
Dividends from 6/10				7,000
Treasury Stock			1,333	
Accrued Income*		275		
Less Expenses £450 x 100/92.5				(486)
Total subject to rate applicable to trusts		**275**	**1,430**	**18,514**
£1,000 x 20%	200			
£430 x 45%	193			
£275 x 45%	124			
£18,514 x 38.1%	7,053			
£486 x 7.5%	36			
Income Tax payable	7,606			

* accrued income all taxable at discretionary trust rates

Interest in Possession

		S	D
	£	£	£
Bank Interest to 5/10		32	
Bank Interest from 6/10		66	
Dividends to 5/10			6,000
Dividends from 6/10			14,000
Treasury Stock		667	
Total		**765**	**20,000**
£765 x 20%	153		
£20,000 x 7.5%	1,500		
Total Income Tax	1,653		

Capital Gains
Treasury stock- exempt
Sweets plc

	£
Proceeds	18,231
Less cost	(5,757)
Gain	12,474
Less: Annual exemption	(6,150)
Taxable Gain	6,324
Tax at 20%	1,264

Total tax payable	£
Income tax Disc.	7,606
Income tax IIP	1,653
CGT	1,264
Total	**10,523**

Tax due 31 January 2022
Tax Pool

	£
Balance b/fwd	2,200
Add tax paid:	
£1,000 x 20%	200
£430 x 45%	193
£275* x 25%	69
£18,514 x 38.1%	7,053
Total	9,715
Less: Tax credits on distributions	
£5,000 x 45/55	(4,090)
Balance c/fwd	5,625

*Tax on accrued income (restricted to 25%)
Income entitlement

Harry	Savings	Dividends
	£	£
	731	13,000
Less tax		
@20% / 7.5%	(146)	(975)
Less expenses 900 x 1/3		(300)
Net income due	585	11,725

Harry R185	Net	Tax
	£	£
Savings	585	146
Dividends	11,725	950

Beth	Savings	Dividends
	£	£
Income entitlement	33	7000
Less tax 20%/7.5%	(6)	(525)
Less expenses 1/6 x 900		(150)
Net income due	27	6,325

Beth R185	Net	Tax
	£	£
Savings	27	6
Dividend	6,325	512

Mae R185	Net	Tax
	£	£
Trust income	5,000	4,090

Inheritance tax due on capital distribution

	£	£
Trust value at 10 year charge		950,000
Nil rate band at exit	325,000	
Less exit July 2015	(20,000)	
Nil rate band remaining	305,000	(305,000)
		645,000
Notional tax at 20%		129,000
Effective rate £129,000/£950,000		13.579%
Actual rate 13.579% x 30% x 18/40		1.833%
Exit charge £20,000 x 1.833%		£366

Tax due 28 February 2021

MARKING GUIDE

TOPIC	**MARKS**
Discretionary Trust calculation	
Apportionment	1
Gross up expenses	1
Tax rates	1
IIP Calculation	
Apportionment	1
Tax rates	1
No expenses	.5
Capital Gains Tax	
No tax on Treasury Stock	1
Tax calculation Sweets Plc	1
Annual exemption	0.5
Tax	0.5
Tax due date	0.5
Tax pool	
25% tax on AIS	0.5
Expenses tax not added	0.5
Other tax added correctly	0.5
Take off distribution	0.5
R185's	
Income due Harry	1
R185 Gross/Net figures	1
Income due Beth	1
R185 Gross/Net figures	1
R185 figures Mae	1
IHT Calculation	
NRB available	1
Effective rate	0.5
Actual rate	1
Tax due	1
Tax due date	0.5
TOTAL	**20**

ANSWER 4

The value of the respective outright gifts made to the children in excess of William and Mary's respective £3,000 annual exemption is treated for each of them as a potentially exempt transfer (PET). These PETs become fully exempt should William and Mary survive their share of the gifts by seven years. However, they would be taken into account on their death within seven years from the date made. Should they survive at least three years from the date of the gifts taper relief would gradually reduce the IHT rate payable thereon. The gifts made in September 2010 are already exempt.

There are two IHT concepts which are relevant to lifetime gifting namely, Gift with Reservation of Benefit (GWROB) and Pre Owned Asset Tax (POAT):

The GWROB rules apply when an individual (the donor) gifts property and the recipient of the gift (the donee) does not assume bona fide possession and enjoyment or the property is not enjoyed to the exclusion of the donor. Where the GWROB rules apply, the gifted asset is treated as remaining within the donor's estate for IHT purposes.

In the event of either or both William and Mary's deaths within seven years of the proposed joint gift of a third share (one sixth each) in Briar Wood, potentially both the PET (valued at date of gift) and the GWROB (valued at date of death) would be subject to IHT. In order to avoid this double tax charge, HMRC would tax the single transaction which yields the highest liability. The GWROB would cease on moving out of the property on Henry's return to the UK but this in turn would create a further PET.

If the GWROB rules do not apply, the Pre Owned Asset Tax (POAT) rules must be considered. POAT applies where, in any year, an individual occupies land / holds chattels and the disposal condition (i.e. has given away the land/chattel) or the contribution condition (has funded the purchase of the land/chattel) are satisfied. POAT is an income tax (IT) charge calculated on the market value rent / deemed benefit for the use of the land or chattel subject to a £5,000 de minimis limit on the amount chargeable.

It is possible to opt out of POAT by electing for the property to be treated under the GWROB rules (as described above).

Gifting/Sale of the main residence

Mary has a terminal illness and is very unlikely to survive the seven years required for her proposed PET to Henry to fall outside her estate. Mary should therefore gift her share of Briar Wood to William so that he is the sole owner of the property and the donor of the onward gift to Henry. The inter-spousal gift would be both CGT and IHT neutral and William would be making a PET of the one third share of the property as it seems more likely that he will survive the seven years required for the PET to achieve fully exempt status.

However, the gift by William to Henry will still be a GWROB as they will both continue to reside in the property. The GWROB would lapse once that occupation ceased provided they do not stay in the house for more than one month per year and do not occupy it for more than two weeks in Henry's absence. They would be able to make visits to Briar Wood for domestic reasons or for some short-term purpose.

Alternatively, the GWROB provisions could be avoided if full market rent is paid throughout for the right to occupy William's gifted one third share of the property. The rental value of the property must be reviewed regularly to ensure that the rent reflects market rate. The payment of market rent will not affect the status of the initial gift as a PET.

As they are planning on selling the remaining two thirds of the property at market value, this part of the property would not be subject to the GWROB rules.

Funding the purchase

Henry is considering using the funds previously gifted by William and Mary to part fund the purchase of the remaining two thirds of Briar Wood.

This would trigger the POAT contribution condition as the cash gifts to Henry will be identified with the purchase of the property in which William and Mary also reside. However, an exclusion from the contribution condition applies where more than seven years have elapsed from the date of the gift of the cash to the date that the donor benefits. If the funds gifted in 2010 were used to fund the purchase a POAT charge could be avoided but not if the funds gifted in 2017 were used. The POAT charge would be calculated on the rental value of the proportion of the property which William and Mary's cash gift was used to buy. In order to avoid the POAT charge they could pay market rent on the proportion of the property which was funded from such gifts.

MARKING GUIDE

TOPIC	**MARKS**
Gifts are PET's	0.5
Annual exemption £3,000	0.5
Taper relief will reduce chargeable amount after three years	0.5
Description of GWROB	
Not a bona fide gift	0.5
Asset remains in estate for IHT	0.5
Relief re double charges	1
Description of POAT	
Disposal or contribution condition apply	1
Income tax charge	1
Possible to opt out	0.5
Gift of 1/3 house	
Gift property to William first	1.0
No CGT or GWROB issues	0.5
GWROB	0.5
Pay rent for the 1/3 share	1.0
Rent needs reviewing regularly	0.5
Gift a PET	0.5
Use of gifts and POAT contribution condition	1
Need to pay additional rent	0.5
Exemption for the older gift	0.5
2/3rd not subject to GWROB	1
William moves out	
No GWROB if Henry occupies main home	1
Virtual exclusion and exemptions	1
TOTAL	**15**

ANSWER 5

1) **2019/20 Income Tax calculation**

	Non-savings £	Savings £	Dividend £
Dividends from LCJ plc			7,000
Dividends from ISA portfolio – Note 2			-
Bank interest – Note 3		2,000	
ISA interest – Note 2		-	
Property income	20,000		
Interest relief – Note 1	(2,000)		
Totals	18,000	2,000	7,000
Tax @ 20%	(3,600)	(400)	
Tax @ 7.5%			(525)
Net estate income	14,400	1,600	6,475
Total tax liability (£3,600+£400+£525)	4,525		

2020/21 Income Tax calculation

	Non-savings £	Savings £	Dividend £
Dividends from LCJ plc			10,000
Dividends from ISA portfolio – Note 2			-
Bank interest		2,500	
ISA interest – Note 2		-	
Property income	30,000		
Interest relief – Note 1	(4,000)		
Totals	26,000	2,500	10,000
Tax @ 20%	5,200	500	
Tax @ 7.5%			750
Net estate income	20,800	2,000	9,250
Total tax liability (£5,200+£500+£750)	6,450		

Note 1:
Where executors have taken out a loan to pay Inheritance Tax, any interest on the loan is a deductible payment. Relief is only available for interest paid within 12 months of the loan being taken out. Interest paid after this date is not deductible for tax purposes. The interest paid on 31 December 2020 is therefore not deductible in the 2020/21 income tax calculation.

Note 2:
The Executors are not taxable on ISA income or gains in either of the 2019/20 or 2020/21 tax years. Where death occurred after 5 April 2018 investments retained in an ISA are deemed to be 'administration-period investments' held in a 'continuing account of a deceased investor' until the earlier of:

- the end of the administration of the estate
- 3rd anniversary of account holder's death
- closure of the ISA account on withdrawal of all assets

Note 3:
Income due up to the date of death, irrelevant of when it is received is assessable on the deceased. The bond interest is therefore not included in the estate income tax calculation.

2019/20 Capital Gain calculation

LCJ plc transactions		Shares	Cost
			£
5 July 2019		100,000	250,000
30 September 2019	Sale	(50,000)	(125,000)
31 October 2019	Rights issue	100,000	200,000
30 November 2019	Bonus issue	300,000	0
31 March 2021	Sale	(450,000)	(325,000)

30 September 2019 - LCJ plc share sale	£
Proceeds	135,000
Less: probate value	(125,000)
Less: cost of obtaining title – Note 4	(1,000)
	9,000

Note 4
Higher of £500 / 2 = £250 or
SP2/04 0.8% x £125,000= £1,000

2020/21 Capital Gains calculation

31 March 2021 - LCJ plc share sale	£
Proceeds	335,000
Less: pool value	(325,000)
Less: cost of obtaining title – Note 5	(2,600)
	7,400

Note 5:
Higher of £500 / 2 = £250 or
SP2/04 0.8% x £325,000 = £2,600

5 April 2021 - sale of rental property	
Proceeds	275,000
Less: probate value	(200,000)
Less: allowable expenditure	(5,000)
Less: cost of obtaining probate – Note 6	(1,600)
	68,400

Note 6:
Higher of £450 or
SP2/04 0.8% x £200,000 = £1,600

Capital Gains Tax liability thereon:

	2019/20
	£
	Tax at 20%
Gain on shares	9,000
Annual exemption	(12,000)
Total chargeable gain / allowable loss	Nil
CGT liability 2019/20	Nil

	2020/21	
	Tax at 20%	Tax at 28%
	£	£
Gain on shares	7,400	
Gain on rental property		68,400
Annual exemption	-	(12,300)
	7,400	56,100
CGT liability 2020/21	1,480	15,708
Total CGT liability 2020/21		17,188

CGT Losses £ (7,000)
Unused losses at the date of death are not available to the estate.

Transfer of main residence
The transfer of the main residence property to Edward is not a CGT disposal by the Executors. It is a distribution of a capital asset. Estate income will be matched to the lower of the capital distribution and Edward's income entitlement.

Sale of ISA portfolio
See note 2.

Tax Summary:

	2019/20	Due date
	£	
Income tax – balancing payment	4,525	
Capital gains tax	Nil	
	4,525	31 January 2021

	2020/21	Due Date
	£	
Income tax - first payment on account	2,262	31 January 2021
Capital Gains Tax – residential property	15,708	5 May 2021*
Income Tax – second payment on account	2,263	31 July 2021
Income tax – balancing payment	1,925	
Capital gains tax – shares	1,480	
	3,405	31 January 2022

*From 6 April 2020 sale of residential property by UK residents (including personal representatives of UK estates) requires the submission of an online residential CGT return within 30 days of completion (assumed 5 April 2021) together with payment of the CGT thereon.

2) 2019/20 R185 figures for Eliza

	Non-savings	Savings	Dividend
	£	£	£
Total net amount	14,400	1,600	6,475
Less: expenses	(750)		
	13,650	1,600	6,475
Eliza's ½ share	6,825	800	3,238
Eliza's total net income	10,863		
Distribution received	5,000		
Net R185 figures	5,000		
Tax R185 figure	1,250		
Net income c/f	1,825	800	3,238

2020/21 R185 figures for Eliza

	Non-savings	Savings	Dividend
	£	£	£
Total net taxable amount	20,800	2,000	9,250
Less: expenses	(3,500)		
	17,300	2,000	9,250
Eliza's ½ share	8,650	1,000	4,625
Net income b/f	1,825	800	3,238
	10,475	1,800	7,863
Eliza's total net income	20,138		
Distribution received	20,000		
Net R185 figures	10,475	1,800	7,725
Tax R185 figure	2,619	450	626
Net income c/f	Nil	Nil	138

2019/20 R185 figures for Edward

	Non-savings	Savings	Dividend
	£	£	£
Total net taxable amount	14,400	1,600	6,475
Less: expenses	(750)		
	13,650	1,600	6,475
Edward's ½ share	6,825	800	3,238
Edward's total net income	10,863		
Distribution received	Nil		
Net R185 figures	Nil		
Tax R185 figure	Nil		
Net income c/f	6,825	800	3,238

2020/21 R185 figures for Edward

	Non-savings	Savings	Dividend
	£	£	£
Total net amount	20,800	2,000	9,250
Less: expenses	(3,500)		
	17,300	2,000	9,250
Edward's ½ share	8,650	1,000	4,625
Net income b/f	6,825	800	3,238
	15,475	1,800	7,863
Edward's total net income	25,138		
Distribution received	240,000		
Net R185 figures	15,475	1,800	7,863
Tax R185 figure	3,869	450	638
Net income c/f	Nil	Nil	Nil

Note:
The administration expenses incurred by the Executors, attributable to the estate income and not otherwise deductible for Income Tax purposes (which will include the £2,000 non tax-deductible loan interest paid in December 2020) can be deducted for the purposes of calculating the net distributable estate income taxable on the beneficiaries. Unlike trust management expenses there is no specific order of set off. Given the dividend allowance it may be preferable to offset against non-dividend income first however marks will be awarded for any order of set off as this can be impacted by the circumstances of the beneficiary (not known).

MARKING GUIDE

TOPIC	MARKS
Income Tax	
Interest due at date of death excluded	0.5
20% tax rate applied to other income & 7.5% tax rate applied to dividends	0.5
Interest relief on IHT loan and against non-savings income (exc. Dec 20)	1.0
Dividends & interest from ISA portfolio, not taxable	0.5
Admin expenses – not tax deductible	0.5
Total income tax liability / net estate income	1.0
CGT	
Shares - Base costs – probate & pool values	1.5
SP02/04 calculations for allowable costs	1.0
Rental property – Base cost, allowable expenditure & SP02/04 calculation for allowable costs	1.5
Transfer of main residence, non-CGT event	0.5
ISA capital gains, not taxable	0.5
Capital losses at death not allowable	0.5
20% CGT rate – shares	0.5
28% CGT rate – rental property	0.5
Allocation of annual exemption – rental property	0.5
Total 2019/20 income tax and capital gains tax liability & due date	0.5
Residential CGT return – due date for payment – 30 days from completion	0.5
Total 2020/21 income tax and capital gains tax liability (shares) – normal due dates, POA1, POA2, BP&CGT	2.0
Subtotal	**14.0**
R185's	
Administration expenses – no specific order of set off – includes Dec 20 loan int.	1.0
Eliza ½ share of net income (2019/20 and 2020/21 – restricted to distributions received)	1.0
Eliza – net non-savings & tax credit (2019/20), c/f	0.5
Eliza – net non-savings income & tax credit (2020/21)	0.5
Eliza – net savings & tax credit (2020/21)	0.5
Eliza – dividend & tax credit (2020/21), c/f	0.5
Edward ½ share of net income (2020/21 on receipt of residence – deemed income – extinguishes entitlement)	0.5
Edward – net non-savings & tax credit (2020/21)	0.5
Edward – net savings & tax credit (2020/21)	0.5
Edward – dividend & tax credit (2020/21)	0.5
Subtotal	**6.0**
TOTAL	**20.0**

ANSWER 6

1)

	£	£
Chargeable lifetime transfer (CLT) – 1 May 2017		
Loss to donor (£2million - £1.2million)		800,000
Less: Business Property Relief (BPR) - note 1		(720,000)
Less: annual exemptions (AE) - 2017/18 and 2016/17		(6,000)
		74,000
Less: Nil Rate Band (NRB)		(74,000)
IHT payable by trustees		Nil
Free estate		
Salt & Pepper Ltd	1,320,000	
Less: BPR - note 1	(1,122,000)	198,000
Main residence		500,000
ISA's		150,000
Bank accounts		150,000
Personal chattels		50,000
		1,048,000
NRB (£325,000 - £74,000)		(251,000)
Transferrable nil rate band (TRNB) - note 2		(162,500)
Residence nil rate band (RNRB)	(175,000)	
Transferrable residence nil rate band (TRNRB) - note 3	(175,000)	
RNRB/TRNRB Taper - note 4	85,000	
RNRB/TRNRB after taper		(265,000)
		369,500
IHT at 40% - payable by executors		147,800

Notes

Note 1

The rate of BPR on unquoted shares held in a trading company is 100%. This is restricted when the company holds "excepted assets" i.e. assets that have neither been used wholly or mainly for the purposes of the business throughout the two years preceding the transfer of value nor required at that time for future use in the business. Surplus cash is an "excepted asset".

30 April 2017

£200,000 / £2million = 10%

Rate of BPR = 100% - 10% = 90%

£800,000 x 100% x 90%	£720,000

Current availability

£330,000 / £2.2million = 15%

Rate of BPR = 100% - 15% = 85%

£1,320,000 x 100% x 85%	£1,122,000

Note 2

The TNRB was introduced in October 2007 and is available when an individual died/s on or after 9 October 2007 even if their spouse or civil partner died before 9 October 2007.
Moira used part of her NRB on death as she left chargeable assets to chargeable persons (James and Holly). To calculate the value of Moira's TNRB available on the event of Adam's death, it is necessary to calculate the percentage claimed by Moira's personal representatives.

£150,000/£300,000 x 100% = 50%

This percentage is then applied to the NRB in force at the date of death of the surviving spouse.

50% x £325,000 = £162,500

Note 3

Like the NRB, any unused percentage of the RNRB is transferrable between spouses and civil partners. As Moira died before the 6 April 2017 (the date when the RNRB was first available) her estate did not use any of the RNRB as it was not available. The full RNRB is therefore available on the event of Adam's death. No taper is required as the value of Moira's estate was below the £2million threshold. The TRNRB is therefore 100% of the current RNRB.

Note 4

The RNRB would be available on the event of Adam's death as James and Holly (direct descendants) will inherit the main residence under the terms of Adam's Will.

It (together with any TRNRB) will however be subject to tapering as the value of Adam's gross estate is more than £2 million. This is calculated before the availability of reliefs and exemptions. There is a tapered withdrawal with £1 lost for every £2 of an estate that exceeds £2million.

Free estate – before sale of shares	
Salt & Pepper Ltd	1,320,000
Main residence	500,000
ISA's	150,000
Bank accounts	150,000
Personal chattels	50,000
	2,170,000

£2.17million - £2million = £170,000, £170,000 / 2 = Taper £85,000

Free estate – after sale of shares	
Cash proceeds of Salt & Pepper Ltd	1,650,000
Main residence	500,000
ISA's	150,000
Bank accounts	150,000
Personal chattels	50,000
	2,500,000

£2.5million - £2million = £500,000, £500,000 / 2 = Taper £250,000

2)

	£	£
CLT – 1 May 2017		
Loss to donor (£2million - £1.2million)		800,000
Less: BPR - note 5		Nil
Less: AE (2017/18 and 2016/17)		(6,000)
		794,000
Less: NRB		(487,500)
		306,500
IHT @ 40%		122,600
Taper relief (4-5 years – 40%)		(49,040)
Less lifetime IHT paid		Nil
IHT payable by trustees		73,560

The trustees' exposure to IHT would reduce by a further 20% each year until fully extinguished on 1 May 2024.

The IHT on the free estate would increase as follows:

Free estate		
Cash proceeds from sale of Salt & Pepper Ltd	1,650,000	
Less: BPR - note 5	(0)	1,650,000
Main residence		500,000
ISA's		150,000
Bank accounts		150,000
Personal chattels		50,000
		2,500,000
NRB (£325,000 - £74,000) - Note 5		(251,000)
TNRB - note 2		(162,500)
RNRB	(175,000)	
TRNB - note 3	(175,000)	
RNRB/TRNRB Taper - note 4	250,000	
RNRB/TRNRB after taper		(100,000)
		1,986,500
IHT at 40% - payable by executors		794,600

If Adam were to die after the sale of the company, there would be an additional combined exposure to IHT of up to £720,360.

Note 5

BPR will cease to be available to the trustees (and Adam's estate) on binding contract for sale of the shares as the business assets (shares in the company) have been converted to cash which does not qualify for relief.

The clawback rules in relation to the CLT do not affect the "lifetime clock" for purposes of determining the amount of nil rate band available to the free estate which remains at £251,000.

MARKING GUIDE

TOPIC	**MARKS**
Current IHT	
CLT – 1 May 2017	
“loss to donor” value	0.5
Availability of BPR, calculation of restriction reference excepted asset	1.5
2 x annual exemptions	1.0
Free Estate	
Availability of BPR, calculation of restriction reference excepted asset	1.5
Restricted NRB – utilisation against CLT	0.5
TNRB – percentage calculation	1.0
RNRB – availability	0.5
TRNRB – unutilised	0.5
Calculate gross value of estate > £2 million – tapering applies	1.0
Tapering calculation applied to RNRB & TRNRB	1.0
IHT @ 40% payable by executors	1.0
Subtotal	**10.0**
IHT after sale of shares	
BPR not available – Adam or trustees = cash	1.0
Trustees – Full NRB utilisation, IHT @ 40%, Taper relief, Nil lifetime tax	2.0
IHT payable by trustees	0.5
CLT out of charge by 1 May 2024	0.5
Free estate – substitute cash proceeds for MV of shares, original NRB before BPR clawback applied to CLT,	1.5
Recalculate gross value of estate > £2 million – tapering applies	1.0
Recalculate taper applied to RNRB & TRNRB	1.0
IHT @ 40%, payable by executors	1.0
Additional IHT exposure	0.5
Identify that “replacement property” rules could be utilised to mitigate – both trustees and Adam	1.0
Subtotal	**10.0**
TOTAL	**20.0**