Institution **CIOT - ATT-CTA**
Course **CTA Adv Tech IHT Trusts and Estates**

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**807**	**3583**	**4386**
Section 2	**504**	**2300**	**2801**
Section 3	**373**	**1756**	**2820**
Section 4	**729**	**3186**	**3915**
Section 5	**523**	**2522**	**4579**
Section 6	**539**	**2492**	**3501**
Total	**3475**	**15839**	**22002**

Answer-to-Question-_1_

Fiona was born in the UK with a UK domicile of origin as she had UK domiciled parents. However Fiona has acquired a domicile of dependence in Australia. Before Fiona seconded to the UK, Fiona is non-UK domiciled as would only be subject to IHT on her UK situs assets.

Fiona set up a non-resident trust in March 2013 (as all the Trustees were non-UK resident) which will acquire the same domicile as Fiona when she set up the trust. The trust is therefore treated as an excluded property trust and any foreign situs assets in the trust would not be subject to UK IHT. Fiona can benefit from the trust so it is treated as a settlor interested trust. The gifts with reservation of benefit rules do not apply as this regime does not apply for an excluded property trust. The trust assets would therefore not form part of Fiona's death estate.

When Fiona moves to the UK she will become UK resident in the 2021/22 tax year. Fiona will not acquire a domicile under in the UK under general law as it is her intention to move back to Australia after her secondment. Fiona will also not acquire a deemed domicile under the 15/20 rule as she is not intending to stay in the UK for that long. However Fiona will acquire a deemed domicile status under the Formerly Domiciled Residents from the 2022/23 tax year because of the following:

1. Fiona was born in the UK; and
2. Fiona has a UK domicile of origin; and
3. Fiona is UK resident in the 2022/23 tax year; and
4. Fiona has been UK resident in at least one of the two previous tax years prior to 2022/23.

As Fiona will become deemed domiciled under the FDR rules, the

domicile of the excluded property trust will also change to having a UK domicile. The assets in the trust will be subject to IHT, which includes the foreign assets. Therefore it will be subject to exit charges and the 10 year charge which will arise on 01/03/2013. The trust will revert back to a non-UK domiciled status when Fiona loses her deemed- domicile status when she leaves the UK and becomes resident in Australia for a tax year.

The trust was non-UK resident before Fiona acquired a residence in the UK as all of the Trustees were non-UK resident. As there is now a mixture of UK and non-UK resident trustees, the residence of the trust depends of the domicile and residence of the trust at the date of creation. As Fiona was both non-UK resident and non-UK domiciled at the date of creation, the trust remains a non-UK resident trust.

However, when a UK resident settlor has an interest in the trust (i.e. is a beneficiary of the trust), the income of the trust is taxed on Fiona as it arises under s.720. There is no relief for any trust expenses. The trust income retains its character in the hands of Fiona. Therefore she will be entitled to use her dividend allowance and savings allowance. If a benefit is received from the trust, Fiona will not be taxed on it again. S.720 operates in the same way as s.624. However s.624 applies to both uk and non-UK trusts. S.624 will take priority in this case.

Non-resident trusts are only subject to CGT on the sale of assets used in a business that is carried on by the Trustees in the UK, or the sale of UK land and property or assets deriving their value from UK property.

However, as Fiona has an interest in the trust and will be UK deemed domiciled under the FDR rules, she will be taxed on the trust gains as they arise under s.86. The charge will cease to apply in the year of the settlors death or when she loses her

deemed domicile status. If Fiona has any personal losses, these can be offset against the s.86 gains. Fiona can recover any CGT from the Trustees.

To mitigate any Income Tax, Fiona could remove herself as a beneficiary of the trust. It would therefore not be treated as a settlor interested trust and she would not be taxed on the income as they arise. This would not avoid the CGT charge as Fiona's children can benefit from the trust so it is still a settlor interested trust for CGT purposes. However this may not be an issue if the trust doesn't sell any assets whilst Fiona is UK resident.

Fiona could consider distributing assets out of the trust to her children before she becomes deemed-UK domiciled. This would not give rise to an exit charge. By distributing the assets now, it will also avoid a CGT emigration charge when the trust becomes non-Uk resident again when Fiona leave the UK.

--------------ANSWER-1-ABOVE---------------

--------------ANSWER-2-BELOW---------------

Answer-to-Question-_2_

Farida will be able to set up a disabled persons trust when she is defined as a disabled person. This will either be when:

1. Farida is in receipt of Attendance Allowance, Disability Living Allowance or a Personal Independence Payment; or

2. She is incapable of administrating her own property or managing her own affairs because of a mental disorder within the meaning of the Mental Health Act 1983.

DPT's can be set up by any person during their lifetime or under the terms of the Will of death.

Most DPT's are discretionary trusts as having an IIP can restrict certain Government benefits which a disabled person can claim.

Income tax relief is available for DPTs. Instead of paying Income Tax at 45% and 38.1%, the income tax liability of the Trustees is calculated as if the trust income had accrued directly to the Farida. The trust can benefit from the personal allowance, basic and higher rate bands and any savings or dividend allowances. Any discretionary distributions to Farida will still carry a 45% tax credit so the Trustees will need to maintain a tax pool. As Farida will have little or no income, she will be able to reclaim back some of the tax suffered.

A DPT will also have CGT relief. The Trustees CGT liability is

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taxed as it would be if it had arisen to Farida. The trustees can use Farida's CGT exempt amount and the tax rates of 10% and 19%.

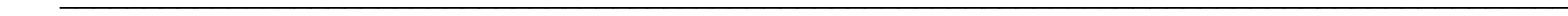
For these tax rules to apply, an election must be made by the Trustees and Farida to HMRC to be treated as a vulnerable person. This election must be made by 31 January after the end of the tax year following that in which it first takes effect. The election will run until either Farida ceases to be a vulnerable person, the trust is no longer a qualifying trust, or when the trust is wound up. Trustees must notify HMRC within 90 days of the event.

The claim for special tax treatment must be made year by year via the Trustee's self-assessment tax return.

A lifetime transfer to a DPT is a potentially exempt transfer. IHT will only be payable if the settlor dies within 7 years of the creation of the trust. Farida would be treated as having a qualifying interest in possession, therefore the capital value of the trust will form part of her death estate. The trust assets are not relevant property and are not subject to exit charges or principal charges.

Farida can self-settle into a DPT before she is classed as a disabled person. The self-settlement is not chargeable to IHT as there will be no loss to her estate. The terms of the trust would be that during the lifetime of Farida, no other beneficiary can benefit from the trust. The trust assets will be treated as forming her death estate. There will be no favourable tax treatment is another individual sets up the trust for Farida before she becomes a vulnerable person.

--------------ANSWER-2-ABOVE---------------



--------------ANSWER-3-BELOW---------------

Answer-to-Question-_3_

The trust will be treated as 1/3 IIP 2/3 discretionary trust for the period 06/04/20- 05/10/20. The trust will then be treated as 2/3 IIP and 1/3 discretionary trust from 06/10/20- 05/04/21.

Trustee's income tax liability:

	SI	DIV	Other
Interest	195		
Dividends		39,000	
Stock	2,000		
Accrued Income			275
Less: IIP (w1)	(765)	(20,000)	(92)
Less: expenses (w2)		(485)	
	1,430	18,515	183

(w1) IIP income:

06/04/20- 05/10/20

Bank Interest= 96 x 1/3= 32
Dividends= 18,000 x 1/3= 6,000
Treasury= 2,000 x 1/3= 667
Accrued Income= 275 x 1/3= 92

06/10/20- 05/04/21

Bank Interest= 99 x 2/3= 66
Dividends= 21,000 x 2/3= 14,000

(w2)

06/04/20- 05/10/20

Expenses= (900/2) x 2/3 x 100/92.5= 324

06/10/20- 05/04/21

Expenses= (900/2) x 1/3 x 100/92.5= 161

<u>Income Tax:</u>

Tax on discretionary part of trust:

SI= 1,000 x 20%= 200
      430 x 45%= 194
DIV= 18,515 x 38.1%= 7,054
    485 x 7.5%= 36
Other= 183 x 45%= 82

Tax on IIP=

SI= 765 x 20%= 153
DIV= 20,000 x 7.5%= 1,500
Other= 92 x 45%= 41

Total tax= 9,260
Add tax pool 6,695
Total= 15,955

Tax pool

Balance b/f 2,200
Add: tax paid (w3) 7,469
Less: distributions
(20,000 x 45/55) (16,364)
Balance c/f Nil

We need to add the negative balance of 6,695 to the tax liability.

(w3)200+ 194+ 7,054+ 21 (82x25%)= 7,469

CGT:

Sale of Treasury Stock is exempt from CGT.

Sale of Shares:

Sale proceeds	18,231
Less: cost	(5,757)

Gain	12,474
Less: AEA	(6,150)
	6,324
CGT @ 20%	1,265

2)

Distribution to Beth on 6/8/20:

R185- Beth

	Net	Tax
NS&I	20,000	16,364

R185- Mae

	Net	Tax
NS&I	5,000	4,090

IIP income distributable:

	SI	DIV	

Gross income	765	20,000	
Less: tax	(153)	(1,500)	
Net income	612	18,500	
Less: expenses (w4)		(450)	
Distributable income	612	18,050	

(n1) The income from the accrued income scheme is not distributed to the beneficiaries as it is a capital receipt.

(w4) (900/2) x 1/3= 150
(900/2) x 2/3 = 300
Total= 450

R185:

	Net	Tax
SI	612	153
DIV	18,050	1,464

3)

A capital distribution has been made so there will be an exit charge.

Value at 5/1/16		950,000
NRB		(325,000)
		625,000
Notional tax (x20%)		125,000
Effective rate (125,000/95,000)x100		13.158%
Actual rate (13.158 x 30% x 18/40)		1.776%

Exit charge= 20,000 x 1.776%= £355

--------------ANSWER-3-ABOVE---------------

--------------ANSWER-4-BELOW---------------

Answer-to-Question-_4_

The gift on 01 September 2010 was a potentially exempt transfer and would only become chargeable to IHT if William died within 7 years of the gift. As more than 7 years has passed from this date, this will be completely exempt from IHT.

The gift of cash on 01 December 2017 is a PET and will become chargeable if either Mary or William died within 7 years. Taper relief would be available as it has been at least 3 years since the date of gift.

If William and Mary gift one third of the property to Henry, this would again be a PET. The value of the PET is the loss to the donors estate as a result of the trasnfer. This would be the difference between a 100% share of the house at the date of gift (here being £2,400,000) and the remaining two thirds. As they are planning the remain in the property after the date of gift until Henry moves back to the UK, this will fall within the gift with reservation of benefit regime. The value of the share in the property will form part of Mary's and William's death estate and will be charged to IHT at 40% after deducting the nil rate band. When a main residence forms a death estate by way of the GWROB rules, the reisdence nil rate band of £175,000 is still available if the property was gifted to a lineal descendant. However, if their net estate is over £2,000,000, the relief will be tapered. If William or Mary were to die within 7 years of the gift, a double tax charge will arise. HMRC will perform two calcultions to see which gives the hightest IHT. The first one will be to ignore the GWROB in the estate and tax the PET, and the second

one would be to ignore the PET and tax the GWROB. As there is a strong possibility that Mary will dies within 7 years of the gift, and before Henry begins to occupy the property, to avoid this charge I would reccomend that William and Mary pay full market rent for the use of the property until they move out. They may also consider sharing occupation with Henry as this would not trigger a GWROB as long as the expenses of the property are shared between donor and donee.

The gift of £1,600,000 to John and Susan will be PETS.

If Henry uses the gift of cash to purchase the other two thirds of the reisdence, the time that William and Mary would live in the property in his absence would fall into the Pre-Owned Asset regime. This regime applies when the GWROB does not. William and Mary would be subject to an income tax charge on the annual rental value of the property. The income must be declared on their tax returns. Any payments made by William and Mary are dedcuted from the charge. If the charge was less than £5,000 it would be ignored, however given the value of the property this is unlikely to be the case. They can elect to be treated under the GWROB of rules instead by 31 January following the end of the tax year, however given Mary's life expenctancy this would not be advisable as the IHT charge on the death estate would be greater.

It would be advisable for Henry to take out the loan to acquire the property so that the POA charge does not arise.

To futher reduce their death estate, William could make any PETs as early as possible. These would become exempt if William dies more than 7 years from the date of gift.

William and Mary can both take advantage of their annual £3,000 exemption to make gifts to their children. They also have their £250 small gifts exemption per recipient each year which is

exempt from IHT. If they have any excess income, they could gift these to their children which would be exempt under normal expenditure out of income, as long as the gifts are habitual and they are left with sufficient enough income to maintain the same standard of living. The marriage gifts of £5,000 to their children is also available.

Mary could also consider life assurance to meet any liability of the failed PETs however this would most likely to significantly high given her condition.

--------------ANSWER-4-ABOVE---------------

--------------ANSWER-5-BELOW---------------

Answer-to-Question-_5_

Income Tax 2019/20

	NS&I	SI	DIV
Rental income	20,000		
Bank interest		3,500 (n2)	
Dividends			7,000
Less: loan interest	(2,000)		
Income	18,000	3,500	7,000
Tax @20%/7.5%	3,600	700	525

(n1) The ISA income and dividends are exempt as they retain their tax free status 3 years from the date of death.

(n2) This is not accrued income as the delay in payment was as a result of an administrative error.

(n3) Trust expenses are not deductible when calculating the income tax.

- The due date for payment is 31 January 2021. Payments on account will be payable. 50% of the liability in 19/20 will be due 31 January 2021 and the other POA will be due 31 July 2021. Executors should consider claiming to reduce the POA as the majority of assets are sold.

Income Tax 2020/21

	NS&I	SI	DIV
Rental income	30,000		
Bank interest		2,500	
Dividends			10,000
Less: loan interest	(4,000)		
Income	26,000	2,500	10,000
Tax @20%/7.5%	5,200	500	750

(w1) Interest on a loan taken out is only deductible for 12 months from the date it was taken out on 30 November 2019. The interest deductible is therefore £4,000(2,000 X 2).

CGT 2019/20

Sale of LCJ shares:

Sale proceeds	135,000
Less: cost (w2)	(125,000)
Less: cost of obtaining probate (w3)	(1,000)
Gain	9,000
Less: losses	(7,000)
Less: AEA	(2,000)
	Nil

(w2) 250,000 /2 = 125,000

(w3)125,000 x 0.8%= £1,000
This is higher than £250 (£500/2) so we use the £1000.

<u>CGT 2020/21</u>

<u>Sale of LCJ shares</u>:

	No of shares	Cost
Balance at 5/4/20	50,000	125,000
Rights issue	100,000 (w4)	200,000

Bonus issue	300,000 (w5)	0
	450,000	325,000
Less: sale	(450,000)	(325,000)
	0	0

(w4) 100,000 shares held at 31 August 2019.

(w5) 150,000 shares held at 1 November 2019.

Sale proceeds	335,000
Less: cost	(325,000)
Less: cost of obtaining probate (w6)	(1,000)
Gain	9,000

(w6) 125,000 x 0.8%= £1,000

Sale of ISA portfolio- this is exempt from CGT.

Sale of rental property

Sale proceeds	275,000

Less: cost	(200,000
Less: cost of sale	(5,000)
Less: cost of obtaining probate (w7	(1,600)
Gain	68,400

(w7) 200,000 x 0.8%= £1600

Shares	9,000	
Property		68,400
Less: AEA		(12,300)
	9,000	56,100
cgt @ 20%/28%	1,800	15,708

The CGT is due 31 January 2022.

2)

<u>2019/20</u>

	NS&I	SI	DIV

Gross income	18,000	3,500	7,000
Less: tax	(3,600)	(700)	(525)
Net income	14,400	2,800	6,475
Less: expenses			(750)
Distributable income	14,400	2,800	5,725
50%	7,200	1,400	2,863
Less: distribution	(5000)		
	2,200	1,400	2,863

R185- Eliza

	Net	Tax
NS&I	5,000	1,250

2020/21

	NS&I	SI	DIV
Gross income	26,000	2,500	10,000
Less: tax	(5,200)	(500)	(750)
Net income	20,800	2,000	9,250
Less: expenses			(1,500)
Distributable income	20,800	2,000	7,750
50%	10,400	1,000	3,875
Add: b/f from 19/20	2,200	1,400	2,863
Eliza	12,600	2,400	6,738
Less: distribution	(12,600)	(2,400)	(5,000)
	0	0	1,738

- The distribution to Edward exceeds his distributable income in the residue so he will be taxed on his share of the residue:

<u>Edward- R185 (resiue)</u>

	Net	Tax
NS&I	17,600	4,400
SI	2,400	600
DIV	6,738	546

Eliza- R185 (distribution)

	Net	Tax
NS&I	12,600	3,150
SI	2,400	600
DIV	5,000	405

Eliza- R185 (residue)

	Net	Tax
DIV	1,738	140

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--------------ANSWER-5-ABOVE--------------
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--------------ANSWER-6-BELOW---------------

Answer-to-Question-_6_

1)

Adam acquired shares in an unlisted trading company in Deecember 2000. Once Adam had held the shares for more than 2 years, the shares will qualify for 100% BPR.

Lifetime gift on 1 May 2017

Value before the gift (100%)	2,000,000
Less: value after the gift (75%)	(1,200,000)
Loss to donor	800,000
Less: BPR (w1)	(705,882)
	94,118
Less: AE x 2	(6,000)
CLT	88,118
Less: NRB	(325,000)
	Nil

(w1) The company has a surplus of cash in the business which is an excepted asset as it is not been used in the company for two years prior to the transfer nor is there any indication that it is required for future use. The BPR will therefore be restricted:

800,000 x 1,500,000/1,700,000 = 705,882

Death tax on lifetime transfer

In this scenario the shares are still held at death so the BPR will not be withdrawn. Even though the excepted assets have increased, the restriction fraction we use in that which is applied at the date of the lifetime transfer.

We need to see if Adam has any unused NRB from his deceased wife:

Chargeable estate	150,000
Less: NRB	(300,000)
Unused NRB	(150,000)

Unsued NRB= 150,000/300,000 x 100= 50%

Adam's NRB on death will be: 325,000 x 1.5= £487,500

CLT	88,118
Less: NRB	(487,500)
	Nil

Unsued NRB= 487,500- 88,188= 399,312

<u>Death estate</u>

Residence	500,000

ISAs	150,000
Bank acc	150,000
Chattels	50,000
	850,000
Less: NRB	(399,312)
Less: RNRB (w1)	(350,000)
	100,688
IHT @ 40%	40,275

(w1) The RNRB is available when the main residence is left to a lineal descendant. Adam will also receive Moria's unsued NRB of 100%. Adam's RNRB at death will therefore be £350,000 (175,000 x 2)

- On Adam's death there will be an exit charge for the Trustees as the assets will pass to the remainderman, which are the children in this case. The trust is a relevant property trust.

The initial value does not take into consideration BPR. We also ignore the loss to donor principals, the shares are valued on a stand alone basis. The stand alone value is £250,000 as the date of trasnfer into the trust. On the exit in the initial value is covered by the NRB therefore there will be no exit charge.

2)

If the Trustees sells the shares before Adam's death, the BPR will be withdrawn on the lifetime gift in May 2017.

Death tax on lifetime transfer

CLT	88,118
Add: BPR withdrawn	705,882
	794,000
Less: NRB	(487,500)
	306,500
IHT @ 40%	122,600
Less: taper relief (40%)	(49,040)
	73,560

The IHT would be payable within 6 months from the end of the month of death. This IHT could be avoided if the Trustees reinvested the net proceeds in qualifying business property within 3 years. The whole of the proceeds must be reinvested and they cannot be used to invest in property qualifying for APR.

Death estate

Residence	500,000
ISAs	150,000
Bank acc	150,000
Chattels	50,000
	850,000
Less: NRB	(Nil)
Less: RNRB (w1)	(350,000)
	500,000
IHT @ 40%	200,000

The sale of shares would again give rise to an exit charge as the assets will be leaving the trust. On the exit in the initial value is covered by the NRB therefore there will be no exit charge.