

THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Inheritance Tax, Trusts & Estates

May 2022

TIME ALLOWED

3 HOURS 30 MINUTES

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2021/22 legislation (including rates and allowances) continues to apply for 2022/23 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

1. Joe Jones is 64 years old and is UK resident and domiciled. He has two adult children and three minor grandchildren.

His wife, Beatrice, died four years ago leaving her £800,000 estate, including her share of their home (The Cottage), to the Jones Family Will Trust. This provides an interest in possession to Joe for his life and on his death to their grandchildren in equal shares absolutely. Beatrice had made no lifetime gifts in the seven years prior to her death.

Joe is concerned about the Inheritance Tax payable on his death and would like to take steps to reduce this. He has made no lifetime gifts to date. Joe holds the following assets:

| | £ |
|----------------------------------------------------|-------------------|
| Shares in listed companies | 175,000 |
| Half share of The Cottage | 625,000 |
| Pension fund | 800,000 |
| Cash in bank accounts | 60,000 |
| ISAs | 80,000 |
| Artwork (not qualifying for conditional exemption) | 140,000 |
| Total | <u>£1,880,000</u> |

Joe had a second pension fund of £500,000 which he used to purchase a single life annuity of £60,000 per annum with no guaranteed minimum period of payment.

Joe has a Will which leaves £200,000 to Age UK (a UK registered charity) and the remainder of his assets as to one third to each of his two children and the remaining one third to his grandchildren.

Joe's brother, Bill, died on 6 March 2022 and left half his estate to Joe and half to their sister Rose. The estate is still in administration, but Joe's share will be approximately £300,000. No Inheritance Tax was paid on Bill's estate.

The assets of the Jones Family Will Trust are:

| | £ |
|----------------------------|-----------------|
| Half share of The Cottage | 625,000 |
| Shares in listed companies | 175,000 |
| Cash | 50,000 |
| Total | <u>£850,000</u> |

Requirement:

- 1) Calculate, with explanations, the Inheritance Tax which would arise on Joe's death. (6)
- 2) Explain the Capital Gains Tax and Inheritance Tax consequences of using a Disclaimer or a Deed of Variation and conclude which option would assist Joe with removing his inheritance from Bill from his estate. (6)
- 3) Advise what other steps could be taken during Joe's lifetime to reduce the Inheritance Tax. (3)

Total (15)

2. Margaret Moore died in December 2021 and is survived by her twin daughters Daisy and Lily who are 14 years old. By her Will, Margaret left her estate to a discretionary trust for the twins until they are 18 years old.

Margaret's husband died 10 years ago leaving his £2.5 million estate to her. He made no gifts in his lifetime.

Margaret was UK domiciled and had made no gifts in the seven years prior to death.

At her death, her estate consisted of the following:

- 1) Her London home valued at £2 million and its contents which were worth £200,000.
- 2) An office, from which she operated her business as an architect through her company Plan to Build Ltd, worth £800,000.
- 3) 100% of the shares in her trading company, Plan to Build Ltd, valued at £300,000. She established the company five years ago and it holds no investment assets.
- 4) In October 2019, Margaret had inherited a painting on the death of her mother as a specific legacy. The painting was then worth £125,000 and Inheritance Tax of £45,000 was paid. The painting is now worth £140,000.
- 5) Cash in her bank account of £30,000.
- 6) Investments of £120,000.

She had the following liabilities:

- 1) A mortgage of £500,000 secured on her home. The mortgage was taken out three years ago and was used to purchase the office.
- 2) A balance owing on her credit card of £4,000.

Funeral expenses were £5,000.

In November 2017, Margaret inherited a property in Spain from her father. The property was then worth £200,000 and Inheritance Tax of £75,000 was paid. Margaret sold the property in December 2019 and spent the proceeds on improving her London home.

Requirement:

- 1) **Calculate with explanations the Inheritance Tax due on Margaret's death.** (7)
- 2) **Explain the tax treatment of the Trust for Margaret's children and any appropriate claims and elections which could be made.** (8)

Total (15)

3. Donald Rice is UK resident and non-UK domiciled. He became UK deemed domiciled in April 2019.

In February 2016, he created the Donald Discretionary Trust in order to protect his wealth from UK tax. The trustees have always been Guernsey resident. The beneficiaries of the Trust are Donald and his two UK resident adult children. Donald has not settled any other trusts.

New trustees, in Guernsey, have recently been appointed and have asked for UK tax advice for the trust. No UK tax advice has previously been taken and no UK tax filings have ever been made by the trustees or the settlor.

No income or capital distributions have been made to the beneficiaries. The trust has not been added to since commencement. The current values of the trust's assets are as follows:

| | |
|---------------------------------------------------|-------------------|
| | £ |
| Cash in a Guernsey bank account | 140,000 |
| Commercial rental property in the UK – Meadowview | 400,000 |
| 100% share in Rice Ltd | <u>800,000</u> |
| | <u>£1,340,000</u> |

Notes

- 1) Rice Ltd is a non-UK resident investment company. In May 2016, it acquired a UK residential property in London for £750,000, which is rented to a third party. The property is currently worth £775,000. The company also holds £25,000 in a Guernsey bank account.
- 2) The trustees have received rental profits of £25,000 per annum from Meadowview since March 2016 when it was purchased for £350,000. The trustees are proposing to sell the property in the current tax year.

Requirement:

- 1) **Explain any current or historic Income Tax and Capital Gains Tax liabilities arising to the trustees and the settlor.** (13)
- 2) **Explain the current Inheritance Tax position for the trustees and the settlor and how this could be improved.** (7)

Total (20)

4. Peter Spanner, age 76, is UK resident and domiciled, and a higher rate taxpayer. He has three adult children, John, Gregory, and Sally who are also UK resident and domiciled. All three are basic rate taxpayers.

Peter's wife, Gladys, died in March 2016. She had not made any lifetime gifts and was UK resident and domiciled.

Under her Will, Gladys created two trusts:

- 1) A life interest trust for Peter comprising her half of the family home. On his death the Trust share passes to the three children absolutely in equal shares. The family home was valued at £350,000 at the time of Gladys's death.
- 2) A discretionary trust for the three children but subject to a £10,000 free of tax annuity to Peter. This comprised the balance of her estate of £600,000. The trust receives £30,000 of UK dividends each year. The trust's assets are now valued at £720,000.

On 23 October 2020, Peter and the Trustees of the life interest trust sold the family home, for £420,000. The Trustees, with Peter's agreement, distributed their 50% share of the sale proceeds to the three children bringing the trust to an end.

On 12 November 2020, Peter gifted £207,000 of his proceeds of the family home to Sally to enable her to purchase a new home, Primrose Cottage. The cash gift from Peter funded 90% of the purchase cost.

Sally later invited Peter to come and live with her in Primrose Cottage rather than continuing to rent a separate house, as he had been since the sale of his home. Peter moved in with Sally on 14 July 2021 and whilst no rent was paid, Peter agreed to pay half of the household running costs.

As at July 2021, the full open market rent for Primrose Cottage was £750 per month and its market value was £250,000.

Peter's assets comprise:

| | £ |
|-------------------------------------|-----------------|
| Cash at bank | 100,000 |
| Cash ISA | 143,000 |
| Life insurance policy death benefit | <u>130,000</u> |
| Total | <u>£373,000</u> |

Under his Will, Peter's estate is left to his three children equally.

Peter did not realise that some of his decisions would give rise to complications in his tax affairs and would like everything sorted out and simplified. He does not want to leave his children with any tax problems, in the event of his death.

Requirement:

- 1) **Explain the tax consequences of the property transactions that Peter has undertaken, and any options available to mitigate these.** (7)
- 2) **Calculate, with explanations, Peter's estate on death and his Inheritance Tax liability, if he were to die now.** (8)

Total (15)

5. George Silver died on 4 April 2020 leaving a net estate of £1.8 million. Although UK domiciled, he was a long-term non-UK resident. His executors are his brother, Fred Silver who is resident in Spain and his sister Julie Gold who is UK resident.

The executors are equal beneficiaries of the estate.

The executors have requested assistance with the tax compliance for the period of administration, which ended on 30 April 2022. All the income accumulated during the period of administration was also distributed on this date, with the capital in the process of being appointed.

The executors have received income, and paid expenses, as follows:

| <u>Income</u> | | <u>2020/21</u> | <u>2021/22</u> | <u>2022/23</u> |
|-------------------|--------------------------|----------------|----------------|----------------|
| | | £ | £ | £ |
| Rental Income | Cottage – Dorset (UK) | 11,250 | 9,000 | 750 |
| | Flat – Paris (France) | 9,200 | 7,200 | 600 |
| Dividends (Gross) | UK Companies | 5,000 | 3,500 | 100 |
| Bank Interest | UK | 3,000 | 2,500 | 100 |
| <u>Expenses</u> | | | | |
| Rental | Agent's fees (UK) | 1,800 | 1,800 | 150 |
| | Management fees (France) | 1,200 | 1,200 | 950 |
| Interest | Loan for Inheritance Tax | 1,500 | 2,500 | |

In September 2020, £80,000 was realised from the sale of UK shares in order to pay the Inheritance Tax due. The agreed probate value of the shares sold was £60,000. The balance of the Inheritance Tax was funded by a bank loan. Loan interest was payable on 31 March each year and the loan was repaid in full on 31 March 2022.

On 30 April 2022, the cottage in Dorset was sold for £345,000 after costs. The agreed probate value was £275,000. In December 2021, the executors had paid £15,000 for a strip of land to give rear access to the cottage to improve prospects of a sale.

Requirement:

- 1) **Prepare the tax computations for the period of administration and show the R185 entries for Julie's share of the estate income.** (16)
- 2) **State how the estate Income Tax and Capital Gains Tax will be reported.** (4)

Total (20)

6. The Sunshine Farm Discretionary Will Trust was established on 31 August 1992, on the death of Fred Johnson. It owns the Sunshine Farm in Devon which Fred had farmed and its farmhouse in which Fred had always lived. Fred had made no lifetime gifts or trusts in the seven years prior to his death.

There are currently four named principal discretionary beneficiaries who are UK resident and are also the Trustees.

The Trustees have the power to operate a trade, as they see fit, to meet the current economic climate. The Trustees operate the trade of the farm in partnership with two of the principal beneficiaries, brothers Tom and Sam. The farmland and buildings remain in the ownership of the trust.

In 2017, the decision was taken to diversify the business to maintain the financial security of the farm. The Trustees are concerned that this will limit available Inheritance Tax reliefs and give rise to a liability on the forthcoming 10-year anniversary. They would also like to know when that liability is due and how much they will need to put aside.

The accountant has provided the following schedule of assets and valuations from the accounts of The Sunshine Farm Discretionary Will Trust:

| | <u>Trust Balance sheet</u> | <u>Market Value on 31 March 2022 (Note 7)</u> | <u>Agricultural value</u> | <u>Notes</u> |
|--------------------------------------------|------------------------------------|-------------------------------------------------------|-------------------------------|--------------|
| | £ | £ | £ | |
| Farmhouse | 50,000 | 650,000 | 450,000 | 1 |
| Farmland excluding Northwest Field | 1,000 | 800,000 | 650,000 | 2 |
| Northwest field | 50 | 25,000 | 20,000 | 3 |
| Barns & units | 145,000 | 400,000 | - | 4 |
| Shop (occupied by Sunshine Farm Shops Ltd) | 250,000 | 300,000 | - | 5 |
| Shareholding in Sunshine Farm Shops Ltd | 80 | 54,400 | - | 6 |
| Tied cottage | 5,000 | 50,000 | 40,000 | 7 |
| Cash at bank | 33,000 | 33,000 | - | |

Notes

- 1) Tom and Sam live with their families in the farmhouse. It is also used as the farm office.
- 2) The farmland is 450 acres and consists of a mixture of grazing, crops, and woodlands.
- 3) The Trustees are in discussions with a property developer for the sale of the Northwest field. An offer of £1.1 million has been made subject to planning permission, which is not due for another six months. They are also considering appointing this field to the four principal beneficiaries. Until a sale is agreed they are continuing to use this field for grazing of farm animals.
- 4) These Barns and units are let, on short-term leases, to various small craft businesses not connected to the farm. These contribute 5% of total turnover and 15% of total profits of the partnership.
- 5) The shop is let to Sunshine Farm Shops Ltd, which operates a farm shop from it.
- 6) The trustees hold 80% of shares and the four named beneficiaries hold 5% each. All shares have been held since incorporation on 1 January 2018 and the trustees are now considering appointing sufficient shares to Tom and Sam so that between them they hold control of the company. The company's Balance Sheet shows the net asset value of the company as £68,000, which is also the company's market value. The assets include a leasehold shop, located in the nearby town, with a current value of £140,000. It was purchased 12 months ago with a loan of £100,000 and £20,000 was spent on refurbishment before it opened six months later.
- 7) The tied cottage is occupied by an elderly retired farm worker who has lived there all his life. He is paid a pension from the Sunshine Farm partnership.
- 8) The cash at bank is all trust capital.

The market values on 31 August 2022 are expected to be the same as on 31 March 2022.

No capital distributions have been made since the previous 10-year anniversary on 31 August 2012. Income is distributed on a regular basis so that no income is accumulated for more than two years.

Requirement:

- 1) **Calculate the 10-year anniversary charge for the Trustees with explanations of any assumptions made and reliefs claimed, and state how it is reported and when the Inheritance Tax is payable.** (11)
- 2) **Explain the tax implications of appointing the field and the shares in Sunshine Farm Shops Ltd to the beneficiaries and of the timing of the appointments.** (4)

Total (15)