

# Introduction

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Administering an estate after someone has died is a lengthy, detailed and technical task. Solicitors receive more complaints about the administration of estates than any other single issue. Few of these complaints involve tax, but fewer than 6% of estates were liable to inheritance tax in the middle of the past decade, according to HM Revenue & Customs (HMRC) and the number has fallen since the introduction of the transferable nil-rate band in 2007 and the fall in property values.

When administering an estate, the three principal UK taxes must be considered – income tax, capital gains tax (CGT) and inheritance tax (IHT).

## Income tax

Income tax must be calculated on income received by the deceased up to the date of death. If there are any outstanding income tax liabilities at the date of death, they reduce the value of the estate subject to IHT.

Thereafter, any income received is taxable on the personal representatives. If the personal representatives later pay income to beneficiaries, tax vouchers must be prepared, so that the beneficiaries can:

- Deal with their own tax obligations.
- Claim credit for, or in some circumstances repayment of, the tax paid.

## Capital gains tax

- Death is not treated as a disposal of assets liable to CGT. The assets are revalued to their market value at the date of death and this is taken to be the acquisition cost for the personal representatives or beneficiary, as appropriate.
- However, CGT liabilities can arise where:
  - The deceased made disposals before death that have to be included on tax returns up to the date of death.
  - A gain on earlier disposals has been held over. In certain limited circumstances, the 'held over' portion of the gain falls due on the death.
  - There is a disposal during the administration period that gives rise to a gain because the value of the asset has risen since the date of death.
- The potential effects of CGT must be considered at every stage of the administration. This includes all disposals, such as sales, as well as distributions of assets directly to beneficiaries.
- If there are any outstanding CGT liabilities in the estate, these liabilities reduce the value of the estate subject to IHT.
- If the deceased had incurred allowable capital losses in the tax year in which he or she died but before death, they can be carried back and set off against chargeable gains in the preceding three tax years. This can result in a repayment of tax to the estate.
- Where the personal representatives sell assets, they can deduct their incidental costs relating to the disposal. Where there is a practical difficulty in allocating specific costs to individual assets in the estate, HMRC accepts allowable expenditure by personal representatives based on a sliding scale. For example, with an estate valued between £70,000 and £300,000, the expense amount deductible from taxable gains is 1% of the

probate value of the assets sold. In practice, HMRC accepts CGT calculations based either on this scale or on the actual expenditure incurred in disposing of the assets.

- Offshore trusts are a minefield of complex rules and changing legislation. Professional advice is essential to determine whether the death has any CGT consequences by reference to the trust.

## **Inheritance tax**

IHT has often been termed the voluntary tax. For example, lifetime gifts enable many assets to be passed on free of IHT provided the donor survives for seven years after the gift.

The 100% business property relief (BPR) certainly helps the family business. However, the rise in house prices until recently has meant that a growing number of people have assets in excess of the IHT nil-rate band (£325,000 for 2010/11 until 2014/15).

The most common will bequeaths 'all to spouse and then to the children in equal shares'. Where the estates of both spouses are within the nil-rate bands (bearing in mind that any nil-rate band not used on the first death can be used on the second death on or after 9 October 2007), no more tax planning might be needed. The personal representatives will need to make a claim for the transfer of any such unused nil-rate band when filing the IHT return on the second death.

Where the estates are worth more than the nil-rate bands available, a different form of bequest could reduce the IHT liability on the second death.

## **Duties of the administration**

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The personal representatives must:

- Collect and administer the real and personal estate, including settled land, of the deceased.
- Show on oath a full inventory of the estate, including settled land, if required to do so by the court.
- Give an account of the administration of the estate to the court when required, and state that the gross estate is worth £X and that the net estate (the gross estate after deducting allowable debts) is worth £Y, to the best of their knowledge. The gross value of the estate determines whether the Probate Registry will require the HMRC Account (form IHT 400) to be completed.

The personal representatives of the deceased have responsibility for the administration. They can appoint professionals to carry it out, and this is usually advisable where there are tax issues.

- Administering the tax aspects of an estate correctly is more important than ever.
  - HMRC has powers to see documents from personal representatives and trustees where IHT is at stake.
  - HMRC can charge penalties for failure to meet compliance obligations.
  - New compliance check powers came into effect from 1 April 2010.
  - Penalties can affect personal representatives, trustees or donees of gifts from the deceased where there is a failure to deliver accounts (initial £100 penalty) or produce information requested by HMRC (possible initial £300 penalty).
  - The maximum penalty is £3,000 where accounts are delivered or information is produced more than a year late.

- In a similar way as under self-assessment for income tax, penalties can be reduced or waived if there is a reasonable excuse.
- There is an appeal procedure if it is thought that the tax inspector does not reasonably require the information or documentation requested.
- There is also a penalty regime for inaccuracies. For events after 31 March 2009, the liable person may be charged a penalty for not taking 'reasonable care' in preparing the inheritance tax account or excepted estate return. There may also be a penalty if the liable person subsequently discovers an inaccuracy but does not take reasonable steps to tell HMRC about it. The test is now of 'reasonable care' rather than 'negligence'.

Behaviour	Disclosure	Minimum penalty	Maximum penalty
Careless	Unprompted	0%	30%
	Prompted	15%	30%
Deliberate	Unprompted	20%	70%
	Prompted	35%	70%
Deliberate and concealed	Unprompted	30%	100%
	Prompted	50%	100%

See [www.hmrc.gov.uk/cto/newsletter-april09.htm#1](http://www.hmrc.gov.uk/cto/newsletter-april09.htm#1) for further details.

- Where there is no tax to pay, form IHT 400 is not normally needed where:
  - The gross value of the estate is less than the excepted estate limit. The excepted estate limit is equal to the nil-rate band (excluding any amount transferred from a spouse/civil partner) except that where death occurs between 6 April and 5 August in any year and application for grant of probate is made before 6 August, the excepted estate limit is the nil-rate band for the previous year or
  - The estate has a gross value of less than £1 million and no IHT is payable because of spouse/civil partner or charity exemption.

Gross value is the value of the deceased's assets before deducting liabilities.

In such cases, form IHT 205 should be completed instead, provided the deceased was domiciled in England, Wales or Northern Ireland. There are different forms if the deceased was domiciled in Scotland or abroad.

There are penalties for incorrectly claiming that an estate is excepted.

## Scheduling the assets

The first job is to make a list of the assets. This list normally has to be revised several times during the administration, unless the deceased was exceptional and kept an exhaustive list. Some items are easily identified, for example, the family home and the bank accounts. Some only come to

light following a discrepancy, for example, some unexplained income that turns out to have come from a trust under an earlier will.

- It is important to identify all assets properly to determine their tax treatment. For example, there might be a lump sum from an insurance policy that is a return of capital. While this might not be taxable for CGT, it will increase the estate transferred on death.
- On the other hand, there could be an income tax liability outstanding before death.

## **Form IHT 400**

The HMRC form IHT 400 guides the personal representatives through all the assets to be identified and if necessary collected. It also lists the probable liabilities that must be paid from the estate. The form gives useful guidance even if ultimately it is not sent in to HMRC. A copy of the form is available from the HMRC website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk) (and is directly downloadable at [www.hmrc.gov.uk/inheritancetax/iht400.pdf](http://www.hmrc.gov.uk/inheritancetax/iht400.pdf)).

The downloaded form may be completed electronically and includes an inbuilt calculator, but the completed form must be printed out as it cannot be saved.

- Form IHT 400 is designed to cope with straightforward estates. It has supplementary schedules to deal with more complex issues. For example, there are supplementary schedules that cover situations where the deceased held assets jointly with others, or had an entitlement under a trust, or was non-UK domiciled.
- There are also supplementary schedules for listed and unlisted stocks and shares, claims for business property and agricultural property relief and other matters.
- The information supplied on the form can result in enquiries from HMRC, with the possibility of delays in obtaining the grant of probate and/or settling the estate.

## **Identifying the tax status of the deceased**

The first page of form IHT 400 asks for basic information about the identity of the deceased, the surviving relatives, income tax reference, and the solicitor or other agent dealing with the estate.

- The date of death defines the nil-rate band to be used in calculating the tax on the estate. From 2010/11 until 2014/15, this is £325,000 before adding any transfer from the earlier death of a spouse or civil partner.
- If the deceased was a widow or widower, the personal representatives will need to obtain details of the IHT position on the late spouse's estate to determine whether any of the nil-rate band was unused. If any part of the nil-rate band was unused, the personal representatives should make a claim (on form IHT 402) for its transfer when filing the IHT return on the second death.
- If a widow or widower has died, one must check to see if their lifetime income was derived from a trust formed out of their late spouse's will on death before 13 November 1974. This is because estate duty would have been paid on the first death under the old tax rules. To avoid a double tax charge, exemption from IHT is given on the death of the surviving spouse. There are still some elderly widows and widowers whose estates benefit from this exemption.
- It is important to establish the deceased person's domicile, because it affects the liability of the estate to IHT. Domicile is a complex subject, but broadly a person is domiciled in the country that they regard as their ultimate home.

- If the deceased was domiciled in the UK, their worldwide assets are liable to IHT.
- If the deceased was resident in the UK for income tax purposes in at least 17 out of the previous 20 tax years, they are treated as UK domiciled for IHT purposes.
- If the deceased was domiciled outside the UK, IHT is payable only on assets situated in the UK, subject to certain limited exemptions. For example, authorised unit trusts and open-ended investment companies (OEICs) in the UK held by a non-UK domiciled person are exempt.

## Finding out what might be missing

The deceased person might have given away valuable gifts or made transfers of value before death. Such gifts would probably have been potentially exempt transfers (PETs). There was no need to report such gifts to HMRC at the time they were made. However, if the gifts were made less than seven years before death, the value of the gifts is included in the estate of the deceased. HMRC provides guidance on its website at [www.hmrc.gov.uk/inheritancetax/](http://www.hmrc.gov.uk/inheritancetax/). Personal representatives are legally obliged to report gifts made by the deceased in the seven years before death, whether or not they were chargeable at the time.

### Potentially exempt transfers

There is no immediate liability to IHT on a PET and no subsequent charge so long as the donor survives for seven years after the gift. Up to 21 March 2006, PETs were gifts to:

- Individuals, including bare trusts.
- Accumulation and maintenance trusts.
- Disabled person's trusts.
- Interest in possession trusts.

From 22 March 2006, gifts to accumulation and maintenance trusts and interest in possession trusts are not PETs. They are chargeable at the time they are made, though no tax is payable if the transfer is within the nil-rate band.

Gifts to discretionary trusts have always been chargeable when made, though likewise are often within the nil-rate band.

A bare trust exists where the trustees act as nominees for the beneficiary (or beneficiaries) who is absolutely entitled to the assets, or would be if aged at least 18. For most purposes, this is not a true trust and beneficiaries are taxed as if they owned the assets absolutely.

PETs will only generally become chargeable to IHT where total gifts made in the seven years before death exceed the nil-rate band. Therefore very few PETs ever attract an IHT liability, although many reduce the available nil-rate band for the estate. Where the PET took place between three and seven years before the death and gives rise to a liability on death, the tax rate (but not the value of the transfer) is tapered. Tapering means that the tax is reduced depending on the time between the gift and the date of death.

Years between transfer and death	% of full tax rate
Not more than 3	100
More than 3 but not more than 4	80
More than 4 but not more than 5	60
More than 5 but not more than 6	40
More than 6 but not more than 7	20

The IHT liability on a PET generally falls on the donee in the first instance, but personal representatives are liable if tax remains outstanding one year after death.

## **Trusts**

Death may result in the deceased giving up an interest under a trust. Where an interest in possession trust was created before 22 March 2006, and in some special cases where it was created since then (see the separate topic 'The tax aspects of administering an estate after death'), the trust property is treated as part of the estate of the beneficiary of the interest in possession.

- There might be a tax liability if the beneficiary ended an entitlement to an interest in possession in settled property within seven years of their death.
- If a beneficiary has transferred an interest in possession, then either the trustees were involved in this transfer or they were informed of the details.
- The tax implications could involve all the taxes under discussion, for example:
  - Was there an income tax liability that now needs to be met from the estate?
  - If the beneficiary ended the entitlement voluntarily, then there might have been a disposal. Such a transfer should not result in a CGT liability, unless the deceased had bought the entitlement from the original beneficiary under the trust.
  - If the trustees ended the entitlement by some power in the trust, then this is not a chargeable event for CGT.

Where property in an interest in possession trust created since 22 March 2006 does not fall within the beneficiary's estate, the estate will not normally be liable to any tax in relation to transfers of the interest within the seven years before death. This can be a complex area. Professional advice should be taken where the deceased has transferred any interest in a trust.

## **Gifts with reservation**

Gifts with reservation are lifetime gifts where the donor has retained an interest or benefit. For example, a donor gives a property to a donee but continues to live in it rent-free. On the donor's death, such gifts are still part of the estate for the purposes of calculating IHT. The personal representatives must be fully advised by all advisers to the estate, such as accountants, solicitors and general managers, and also by the family, so that they can give HMRC full information.

## **Pre-owned assets**

From 6 April 2005, income tax is charged on the benefit people get by having free or low-cost enjoyment or use of certain assets they formerly owned, or provided the funds to purchase. The deceased may have opted out of this tax charge by electing on form IHT 500 for the asset to be treated as part of their estate and subject to IHT on death. Assets subject to such an election must be declared to HMRC.

## **Property held for someone else**

Property is sometimes purported to be held by or on behalf of someone else, say, a child. Where such situations occur, the tax position can be complicated and specialist advice might be needed so that the executors do not expose themselves to risks. It is particularly important to take advice if it appears that any purported arrangements might not reflect the real position.

## **Co-ownership of property**

The deceased might have owned property jointly with someone else.

- Holding property as joint tenants is very common for married couples and families.

- The jointly owned property passes by survivorship, independently of any will. This leaves the surviving spouse and family secure in the family home.
  - This is true of all assets held jointly, whether chattels real or personal, land or money, or other valuable rights.
  - Unless there is a trust, deed or memorandum showing the proportion of the property held by each co-owner, the value is divided equally between all the parties and the deceased's proportion is included in the estate of the deceased and recorded on form IHT 400.
- If the property was held as tenants in common, the share of the property owned by the deceased does not automatically go to the other owners. Instead, it goes to the beneficiaries under the deceased's will.

### **Debts**

The personal representatives must reduce the value of the joint holding by any debts that are secured on the jointly owned property and which were the responsibility of the deceased. For example, the value of a jointly owned home is reduced by any mortgage liability on it, provided the mortgage has not been repaid out of an insurance policy as a result of the death, as is often the case.

### **Excluded property**

Excluded property is exempt from IHT. Excluded property includes:

- A reversionary interest in a settlement, unless it was acquired for money's worth.
- Non-UK assets of an individual not domiciled in the UK.
- Overseas property in a non-UK settlement, where the settlor was not domiciled in the UK when the settlement was made.

### **The free estate**

IHT 400 and its supplementary schedules list the majority of types of asset. The form itself provides for:

- An analysis of accrued but unpaid income, for example, dividends that have been declared but have not yet been paid.
- Directors' fees or other income not yet paid.
- Income arising under a trust of which the deceased was a beneficiary.

Income tax repayable is regarded as an asset of the free estate. This cannot usually be precisely calculated until later in the administration.

### **Household goods**

The belongings of the deceased, the household goods, are part of the free estate. The personal representatives might need to take advice regarding their true ownership. In a family household, it is likely that the majority of household goods are jointly owned. But there could be individual items of value that belonged outright to the deceased. Conversely, the deceased might have had no part in some items because they originated from 'the other side of the family' and belong to the surviving spouse or civil partner, or even to the children.

### **ISAs and child trust funds**

The tax exemptions of investments in individual savings accounts (ISAs) (including former personal equity plans (PEPs)) and child trust funds (CTFs) only relate to income tax and CGT, so their capital value is still brought into account for IHT. Interest on such investments can be paid or

credited gross of tax up to the date of death, but thereafter the investments no longer qualify for the income tax and CGT exemptions.

Personal representatives are liable to tax on interest paid after death.

### **Pension funds**

The impact of death on pension fund entitlements depends on the arrangements in force. There are many possibilities, so this area needs to be investigated carefully. For example, there could be entitlements to:

- An annuity with a guaranteed minimum payment term, which will continue for a period after death.
- A pension for a spouse and/or other dependants.
- A payment of the accumulated fund into the estate where the pension had not yet started being paid.
- A lump sum for beneficiaries under a discretionary trust arrangement. This lump sum does not go into the estate but it still needs to be claimed and administered.

### **Interest in other estates**

Any interest in another estate to which the deceased was entitled, but which has not yet been administered, is part of the free estate. Further enquiries are necessary because 'quick succession' relief could be available if the deaths were less than five years apart – see the separate topic 'The tax aspects of administering an estate after death'.

### **Insurance policies**

There are many types of insurance policies, as well as savings and investments involving an insurance element.

- Some policies are written 'in trust' for the beneficiaries, so that the benefits payable on death are not included in the estate of the deceased.
- When benefits are paid, the insurance company will issue a certificate if there is any potential tax liability on the benefit. The precise position depends on whether the policy is a qualifying policy or a non-qualifying policy. Broadly, a qualifying policy is not subject to an income tax charge. A UK non-qualifying policy could be subject to a 50% additional rate tax charge (less a deemed payment of 20% basic rate tax) on the policy gains, resulting in an effective tax rate of 30%. Offshore policies are subject to a full income tax charge. 'Top slicing' relief for policy gains may be available on the maturity of non-qualifying policies.
- Care must always be taken to deal with these correctly. 'Chargeable events' on gains from non-qualifying policies that are subject to higher rates of income tax must be declared on the tax return to the date of death. This is so despite the fact that the 'event' (the maturity of the policy) appears to have arisen after and because of the death.

### **Interest on personal representatives' accounts**

The personal representatives should bank all sums collected on behalf of the estate.

- Where there are minimal assets to manage and the administration follows a rapid timetable, the estate funds can be held in a non-interest earning account for a very short period.
- In any other situation, the funds must be placed in an interest earning account as soon as possible.
- The estate is not entitled to any personal income tax reliefs or allowances.

- Income tax at 20% is payable on all income received by the estate during the administration except for dividend income. The most common forms of income during administration are interest and rents.
- Dividends are taxable at 10%, which in the case of UK dividends is covered by the tax credit.
- When interest or income earned during the period of administration is passed to beneficiaries as estate income, the tax already paid satisfies any personal basic rate tax liability.
  - Beneficiaries who pay tax at the higher rate or additional rate have extra tax to pay.
  - Beneficiaries who do not pay tax, or who pay tax on savings income at only 10%, can claim a tax refund, except that no repayment can be made in respect of the tax credits on dividends or the tax element of amounts treated as having suffered tax at source, e.g. UK life assurance gains.

## Paying the debts

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When cash starts to arrive in the estate, the personal representatives can start paying the outstanding bills.

- Normally, but not always, the expenses come out of the residue of the estate. The IHT on the whole of a taxable estate is borne by the portion of the estate that is designated to bear the costs and outstanding debts.
- In the absence of a will showing that the debts are paid out before calculating the residue for distribution, the order of payment is set out by Schedule 1 of the Administration of Estates Act 1925 (part II). For example, debts charged against specific property or a specific fund would have to be satisfied out of that fund or property, and not out of other assets in the estate.
- The personal representatives have ‘the executor’s year’ to pay final distributions to the beneficiaries. It is the duty of the personal representatives to pay bills quickly, however, and certainly before the 12 months are up. All personal debts of the deceased are payable by the estate, as are the funeral expenses, including a ‘reasonable sum’ for a tombstone and for mourning expenses.

## Business property

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The gross value of any business property must be adjusted for any liabilities secured on the assets over and above those indicated in the business accounts. For example, the deceased might have a controlling shareholding in a company, and might have pledged this as security for loans that are outstanding at the death.

### Business property relief

BPR is given on transfers of assets (including the transfer resulting from death) provided the transferor had owned them for at least two years. Relief is not available where the business consists of dealing in securities or land and buildings, or making investments.

Relief is also not available where the asset is subject to a binding contract for sale at the date of death, for example, a partnership share where the remaining partners are obliged to buy out the deceased’s interest.

100% relief is given on:

- A business or an interest in a business, for example, a partnership share.
- Shares in unlisted and Alternative Investment Market (AIM) companies.

50% relief is given on:

- Assets, for example, land and buildings or plant and machinery, owned by the transferor and used for a business carried on by:
  - A company controlled by the transferor.
  - A partnership in which the transferor was a partner.
  - The transferor him or herself, where the business is settled property in which the transferor had an interest in possession.
- Controlling interests in listed companies.

It is extremely important to safeguard the conditions for claiming BPR (especially, where relevant, the 100% rate) in view of the large tax savings this produces.

### **Agricultural property relief (APR)**

For transfers of owner-occupied farms and tenanted farms in the UK, Channel Islands, Isle of Man or another EEA state, 100% relief is potentially available where the transferor had vacant possession of the land, or could have had within 12 months.

- 100% relief is also available where this condition is not met but the land is tenanted under a lease that started after 31 August 1995.
- For tenanted land where the lease started before 1 September 1995, 50% relief is available.

### **Woodlands relief**

IHT on growing timber in the UK or in another EEA state (but not the land) is deferred until disposal of the timber. However, if the deceased occupied the woodlands for commercial purposes, 100% BPR may be available, which is preferable to deferment.

## **Land and buildings**

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The land registry lists titles to land but the registers are not sorted by owner's name. The landholdings of the deceased are discovered only by personal records, or through their advisers or mortgagees. Land or 'an interest in land', which includes leases, is often the deceased's main asset.

- The ownership of land held under a joint tenancy passes by survivorship. However, for tax purposes, the value of the land or buildings attributable to the share owned by the deceased is included in the calculation of the estate.
- How the deceased came by the asset can affect the current tax position. For example, was it transferred out of a trust?
- The deceased might have occupied their residence under a 'lease carve-out', having given away the freehold. Special rules apply, even if the deceased was not resident there on death, but had lived there at any time within seven years up to the date of death. The tax

implications of lease carve-outs are highly complicated and professional advice must be taken.

- It is possible to pay IHT due on land and buildings by instalments over ten years. This facility is withdrawn if the land is sold. At that point, any balance of outstanding tax becomes payable in full.

There are many rules and privileges on the sale of land out of an estate. For example, if personal representatives sell land at a loss within four years of the death, IHT relief may be claimed by replacing the original death-date values with the actual pre-expenses sale proceeds.

## Foreign assets

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IHT may be payable on assets anywhere in the world if the deceased was domiciled in the UK. For example, both a 'time share' and a 'villa in Spain' increase the value of the estate on death.

- Liabilities in respect of these properties may be offset against their value. Tax on interests in land overseas can also be paid by the instalment option. Full advantage should be taken of any double tax treaty available, to prevent tax arising twice on the same asset in two different countries.
- The UK tax authorities normally allow credit against UK IHT for any foreign equivalent of IHT paid on overseas assets. This relief may be given unilaterally even where there is no double tax treaty or specific provision.
- More problems can be caused by foreign succession laws than foreign tax rules. The validity and application of foreign wills or foreign intestacy rules to property physically situated in another jurisdiction can be subject to local laws that may define how property is passed down. This is a very specialised field. Professional advice should be taken where appropriate.

## Settled property

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A list must be prepared of all property to which the deceased was treated as if they were entitled outright, for example, where the deceased could determine how money was to be spent. IHT 400 requires cross-referencing to any entitlements under trusts.

- Even if the deceased was simply a 'tenant for life' and all entitlement ended on death, the deceased's own estate is valued as if the capital fund from the life interest was part of that estate.
- IHT is calculated on the total amount, and then paid proportionately by personal representatives out of the estate and by trustees out of the trust fund.
- An interest in an interest in possession trust created after 21 March 2006 will only be treated in this way if it is one of the following:
  - An immediate post-death interest. This is an interest created by will or on intestacy that arises on the death of the testator or intestate.
  - A disabled person's interest.
  - A transitional serial interest. This is broadly an interest that existed before 22 March 2006 that was transferred to the deceased since then but before 6 October 2008, or after that date in certain limited circumstances.

## Valuing the assets

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The value of assets for IHT is their open market value at the date of death. Valuing the estate is a professional task and can account for a great deal of the time spent in administration.

- Shares that form part of a holding of less than 50% in an unlisted company are usually valued at less than shares forming part of a majority holding. Valuations could be affected by 'related property'. For example, where a husband and wife both hold 45% of the shares in a company, the value of each holding will be based on the valuation of a 90% holding.
- There are special rules for some types of asset to ensure the whole value is assessed. These include life assurance policies, works of art, 'heritage' property, business property and agricultural property.
- There is anti-avoidance legislation to ensure IHT is not reduced by splitting a transfer into separate parts, the sum of which is less than the total value actually transferred. The 'associated operations' legislation is aimed at devices such as annuities bought in conjunction with life assurance policies. Where there have been associated operations, the onus is on the personal representatives to show that the legislation should not apply.
- Where listed securities are sold at a loss within 12 months after death, the personal representatives can replace the value at death by the sale proceeds in the IHT calculation. The proceeds of all listed shares disposed of in that period must be substituted, i.e. including any sold at above their death value.

## Calculating the IHT and settling the tax bill

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IHT is chargeable on the value transferred by a chargeable transfer on death. For 2011/12, the rate is 40% on transfers above the nil-rate band (£325,000), which, for deaths on or after 9 October 2007, includes any unused nil-rate band transferred as a result of the earlier death of a spouse or civil partner. Tax is paid only on chargeable transfers.

Some transfers are exempt. All transfers to the spouse or civil partner are exempt from IHT, provided that the spouse/partner is domiciled in the UK. It could be worth rearranging a will so that it creates a family discretionary trust from which the surviving spouse or civil partner could benefit. However, this has become less necessary since it has become possible to transfer the nil-rate band.

### Deed of variation

Even where there is a will, too little attention might have been paid to the preservation of the family estate. It is possible to vary the disposition of the estate using a deed of variation. In effect, this rewrites the will for tax purposes. Various conditions must be met.

- The deed must be made within two years of the death.
- With one exception, all the beneficiaries of the will must agree to be parties to the deed of variation and must be alive and competent to execute legal documents. The exception is where one party to a marriage dies, and the second party dies within two years, so that there are two administrations. Then it is possible to execute a deed of variation for the first will even though the second party (now dead) was a beneficiary of that first will.
- The deed operates from the death of the deceased, either instead of the rules of intestacy or to vary the inadequate arrangements of the will.
- It is important to consider the overall effects of the deed. For example, any recent developments in case law and legislation must be considered before assuming that a

tax-effective trust can be set up by a deed of variation. It is much safer to set up a trust through a will than to assume that a variation after death can be relied upon for tax advantages.

- These deeds are not automatically effective in backdating the effects of IHT or CGT to the date of death. The beneficiaries can elect for the dispositions under the deed to be treated as if made by the deceased for IHT and some CGT purposes.
  - A deed of variation must contain a statement that the variation is to have effect for IHT as if the deceased had made it. The statement must be signed by all the parties making the variation and, where the variation increases the IHT payable, by the personal representatives. However, the personal representatives can only decline to sign if they do not hold sufficient assets to pay the additional tax.
  - If the deed does result in additional IHT, the parties to it must send HMRC a copy of the deed and details of the amount of additional tax within six months of the deed being made.
  - A separate signed statement must be included in the deed if it is to be effective for CGT as if the deceased had made the variation.
- If a deed of variation within two years of the date of death creates a trust, this is treated for all IHT purposes as made by the deceased. Notwithstanding changes in 2006 to the treatment of trusts, it is still possible in a two-year window after death to use trusts to rearrange affairs in a more tax-efficient manner, which also ensures that large sums of capital do not have to go directly to children or very young adults.
- A deed of variation cannot be used to make the deceased a settlor of a trust set up by the deed for the purpose of CGT or income tax. The original beneficiary whose interest is given up under the deed will be regarded as the settlor. Anti-avoidance legislation makes a settlor liable for trust gains and income in certain circumstances, for example, when the settlor is able to benefit from the trust.
- Different circumstances give different planning opportunities. It is possible to have a variation:
  - For succession purposes only, with no tax elections.
  - With an IHT but no CGT election.
  - With a CGT but no IHT election.
  - With both tax elections.
- It is not possible to elect to make the deed effective for income tax back to the date of death.
  - Any income tax liability remains exactly as it was according to the original will or intestacy, even if there is now a new recipient of the funds.
  - The rule that allocates estate income to the year of payment, rather than to the underlying years of receipt, provides some opportunity for obtaining income tax advantages under variations.

## Rules of intestacy

A 'pure intestacy' (where there is an estate and children of age to benefit) might make more effective use of the exemptions and nil-rate band for IHT than the classic 'all-to-spouse' will. But the result might not reflect the wishes of the deceased. The rules in England and Wales differ from those in Scotland and from those in Northern Ireland.

With effect from 1 February 2009 the rules in England and Wales are:

### **Married or civil partners with children**

- Spouse or civil partner gets everything up to £250,000 plus personal possessions.
- Remainder is divided into two: half to the children at 18 or earlier marriage, half in trust during spouse's lifetime, during which he or she gets the income. On spouse's or partner's death, this half goes to the children. If a child predeceases, leaving issue, the issue will take his or her share between them (*per stirpes*).

### **Married or civil partners, no children**

- If there are parents, brothers or sisters of the whole blood, nephews or nieces:
  - Spouse or civil partner gets everything up to £450,000 plus personal possessions.
  - Remainder is divided into two: half of this goes to spouse or partner, half to parents. If no parent is living then it goes to brothers or sisters or their children.

### **Married or civil partners, no parents, brothers or sisters of the whole blood, nephews or nieces**

- Spouse or civil partner takes whole estate.

### **Unmarried person with children**

- Estate goes to children at 18 or earlier marriage.
- If a child predeceases, leaving issue, their issue take *per stirpes*.

### **Unmarried person with no children**

- Estate goes to parents.
- If none, then to siblings of the whole blood or their issue.
- If none, then to siblings of the half blood or their issue.
- If none, then to grandparents.
- If none, then to uncles and aunts of the whole blood or their issue.
- If none, then to uncles and aunts of the half blood or their issue.
- If there are no parents, siblings (whole or half blood), issue of siblings, grandparents, uncles and aunts (whole or half blood), or issue of uncles or aunts, estate goes to the Crown (or to the Duchy of Lancaster or the Duke of Cornwall).

### **Exemptions for IHT**

Each exemption must be claimed on form IHT 400. The main exemptions are:

- Transfers between husbands and wives or civil partners.
- The annual lifetime exemption of up to £3,000 per donor.
- Small gifts of up to £250 per donee.
- Normal expenditure during lifetime that is regular, made out of income and does not reduce the donor's normal standard of living.

- Gifts in consideration of marriage or civil partnership:
  - By a parent, up to £5,000.
  - By a grandparent or a party to the marriage or civil partnership, up to £2,500.
  - By another person, up to £1,000.
- Gifts to charity, political parties or for national purposes, for example, to various museums or other public institutions.

### Quick succession relief

Where someone dies within five years of receiving a chargeable transfer from another person, a credit is given for part of the tax paid on the previous transfer.

Maximum time between transfers (years)	Credit %
1	100
2	80
3	60
4	40
5	20

### Calculating the tax for individual assets

- The most difficult tax exercise is to define and identify from the will which legacies:
  - Bear their own tax.
  - Do not bear their own tax, as specified in the will.
  - Are exempt from tax.
- If there is a partially exempt estate and there are specific gifts that are not stated to bear their own tax, then the calculation of the tax payable involves 'grossing up'. This is to make sure that the tax calculated is the same, whether the legacy is at the grossed up figure, bearing its own tax, or at a net figure, not bearing its own tax.
- There are rules about the interaction of the reliefs for agricultural and business property and the rules for partly exempt transfers.

### Paying the IHT

With full knowledge of the assets, the personal representatives can then calculate the IHT due, if any, pay it and obtain the Grant of Probate.

- If there are insufficient funds available to pay the IHT immediately, the personal representatives can raise a loan.
- Alternatively, a voluntary scheme agreed between the British Bankers' Association, the Building Societies' Association and the government has enabled personal representatives to pay IHT by electronic transfer out of the balance in the deceased's accounts at participating institutions.

It is also possible to arrange for IHT to be paid out of most National Savings investments and government stocks on the Bank of England register held by the deceased. HMRC's

website (at [www.hmrc.gov.uk/inheritance tax/paying-iht/find-money-to-pay](http://www.hmrc.gov.uk/inheritance-tax/paying-iht/find-money-to-pay)) explains how to do this.

- The sheer size of the job of administration and the difficulty of assessing values, including the discovery of debts outstanding against the estate, means that the assessment of tax due frequently changes.
- It is possible to submit a 'corrective account' more than once before the IHT is finalised. A corrective account can be for an underpayment or overpayment of IHT.
- Tax is payable on the Grant of Probate, or within six months of the death, or in instalments where the election has been made.
- Interest is payable where the tax is overdue. The interest rate has been 3.0% since 29 September 2009.

## **Paying tax by instalments**

Where tax can be paid by instalments, one-tenth of the tax due on the asset is paid within six months of the death, and after that at annual intervals.

The instalment option is only available on the following:

- Land and buildings, situated anywhere in the world.
- The net value of a business or an interest in a business, for example, a share in a partnership.
- Shareholdings that gave the deceased control of the company. Husband and wife/civil partners' holdings are added together.
- Unlisted shares or securities that might not have given control but where some conditions were met or undue hardship would result if the instalment option were not available.

The instalment option on shares and business interests is of little significance because these assets often qualify for the 100% BPR. The instalment option has been attractive for land and buildings because of the relatively low interest rate historically charged. Since September 2009, however, interest on IHT has been charged at 2.5% above base rate, little different to commercial interest rates.

## **Distribution**

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Once the Grant of Probate or Letters of Administration have been granted, and the personal representatives are satisfied that all possible liabilities of the estate have been identified, by advertisement if necessary, then distribution can start.

Often, there might have been interim distributions, but the distribution starts properly once the debts have been paid.

- Beneficiaries are entitled to receive income from specific legacies from the date of death, for example, dividends on shareholdings.
- If the legacy is a sum of money, the beneficiaries are generally entitled to interest from the end of the executor's year; that is, they start to receive interest if the legacy still remains unpaid 12 months after the death.
- Personal representatives and trustees must supply form R185 certifying estate income or trust income and the income tax already paid on the income. This is so that beneficiaries can:

- Deal with their own tax obligations.
- Claim credit for, or in some circumstances repayment of, the tax paid.

Because of differing tax rates on different types of income, it is important to identify properly income arising during the administration.

- The estate is taxed on income it receives if no beneficiary is entitled in preference to the estate itself.
- The estate is also chargeable to CGT for disposals of chargeable assets at a gain (over probate value) during the administration.
  - Gains can be offset by the same annual exemption as an individual (£10,600 of net gains for 2011/12). The annual exemption is only available for the tax year in which the death occurred and the next two tax years.
  - Personal representatives are liable to CGT at 28%.
- When a beneficiary receives an asset from the estate in accordance with the will, it is received at its value at the date of death. There is no CGT liability on the personal representatives.
- CGT planning should always be considered during the administration. There are circumstances in which tax could be saved by the beneficiaries disposing of assets themselves, rather than the personal representatives selling the assets and passing post-tax proceeds to the beneficiaries, or vice versa.
  - Beneficiaries might or might not have annual exemptions available that they can set against their own gains.
  - Beneficiaries might have capital losses that they can set against gains.
- The main or principal residence of the deceased during their lifetime is normally not chargeable to CGT. CGT is only likely to arise in exceptional circumstances, for example, a profitable sale of a property that had remained unoccupied by any beneficiaries for several years after the death.

## Tax planning key points

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- Once the personal representatives have:
  - Ascertained a clear residue, that is, the net estate of the deceased having paid all due tax, with the exception of instalments not yet due,
  - Obtained the Grant of Probate, and
  - Satisfied all outstanding debts,
 then, technically, their functions change to those of 'trustees'. Trustees have obligations that continue for ongoing trusts under the will after the administration proper is at an end.
- The duties of a personal representative (whether as an executor under a valid will or as an administrator under Letters of Administration) can continue for life if necessary. Professionals can be instructed to carry out the technical aspects of gathering in the assets, taxation and paying out, but the responsibility is personal and ongoing. If the estate has not been finalised, the responsibility passes on death to the next nominated executor of the will of that personal representative. This is the 'chain of executorship'.

- The responsibilities imposed in the administration of an estate and any continuing trusts can last well beyond the lifetime of all those involved when the will was drawn up. The personal representatives could well find the duties being discharged under an entirely different tax regime to that under which the original will was drawn.
- An awareness by personal representatives of current tax planning advantages, traps or compliance obligations is increasingly important.

*This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at September 2011, which are subject to change.*