

# ILM Factsheet

## Advanced Inheritance Tax by Gaynor Jackson

In the ILM fact-sheet "An Introduction to Inheritance Tax" the basics of IHT were discussed; this fact-sheet will concentrate on a few advanced aspects of this tax.

### Gifts within 7 years of death

One of the most vital questions for a personal representative to ask is "Did the deceased make any gifts in the seven years before death that were not covered by any exemption to IHT?" If the answer is yes, the gifts will eat into the Nil Rate Band and will affect the amount of IHT payable by the estate. In addition, if gifts have exceeded the Nil Rate Band there will be IHT payable on them too.

Gifts are deducted from the Nil Rate Band on a first come first served basis.

If lifetime gifts exceed the Nil Rate Band, the tax on those gifts is charged at the full rate of 40%; however taper relief is available against the tax on those gifts using the following table:

Years between gift and death	Percentage of full tax rate
3 years or less	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 persons liable for the tax on the lifetime gifts are:

A.

- I. anyone the value of whose estate has increased by the transfer
- II. anyone in who the asset had been vested or, who is beneficially entitled to an interest in possession to it at any time after the transfer (this would include nominees, trustees, life tenants)
- III. where the gift is into a trust, anyone for the benefit of whom the property or the income from it is applied (this would cover beneficiaries of discretionary trusts who receive a benefit)

The liability to the above persons is limited to the tax attributable to the asset transferred without grossing up. In addition their liability is limited further:

- I. for trustees, it's limited to the value of property received, disposed of or for which he has become liable to account to the beneficiaries, plus any other assets in his hands available for the payment of the tax
- II. any person in (ii) above other than the trustees but only to the extent of the value of the property concerned
- III. anyone within (iii) but only to the extent of the property or income applied for his benefit

B. the personal representatives if:

- I. No one else in (a) above is liable due to
- II. The tax is still unpaid 12 months after the end of the month that the death occurred

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However the personal representatives are only liable to the extent of unsettled assets they receive and UK land settled immediately before death any available in their hands for the payment of tax at any time.

The Capital Taxes Office Advanced Instruction Manual states that the pursuit of payment by the personal representatives is a sensitive area and that they should be informed at an early stage if "...recourse to then might occur...". In exceptional circumstances, it is possible that the beneficiaries of an estate could be pursued for the payment of the tax (but only to the extent of assets received by them).

### **Gifts with Reservation of Benefit**

If the deceased made a gift at any time after 17 March 1986 and at any time thereafter either:

- A. Possession and enjoyment was not properly taken by the donee on or before the period of 7 years prior to the death of the donor ("the Relevant Period"); or
- B. At any time during the Relevant Period the asset was not enjoyed virtually to the entire exclusion of the donor then, subject to certain exceptions, the effect is that:
  - I. The property that is subject to the reservation is treated as belonging to the donor for the purpose of calculating the IHT; and
  - II. If it had ceased to be a gift with a reservation of benefit within the 7 years prior to death, the donor is treated as having made a disposition of it at that date.

An obvious example of a gift with reservation of benefit is a gift of a house in which the donor of the gift remains living and the donee of the gift lives elsewhere.

### **Quick Succession Relief (QSR)**

Deeds of Variation were covered in the "An Introduction to Inheritance Tax" factsheet, however, after the period of two years following death it is not possible to obtain the Inheritance Tax saving that a Variation may produce. QSR is available where a transfer occurs within 5 years of an earlier one, which increased the value of the second transferor's estate and, the later transfer:

- I. Arises on death, or
- II. Is of settled property and certain conditions are fulfilled;

then the amount of tax payable on the second transfer is reduced using the formula:

Percentage x Tax on earlier chargeable transfer x Amount of increase of deceased's estate/Value of earlier chargeable transfer

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The Percentages are:

Time between transfers	Percentage
One year or less	100%
More than one year but not more than 2	80%
More than 2 years but not more than 3	60%
More than 3 years but not more than 4	40%
More than 4 years but not more than 5	20%

### Interest on Inheritance tax

On death, Inheritance Tax is due (the due date):

- on transfers on death
- on transfers within 7 years of death; or
- on the termination of an interest in possession of settled property within 6 months of the end of the month of death.

Subject to electing to pay Inheritance Tax in 10 equal annual instalments on certain assets, personal representatives must pay the liability to inheritance Tax on the delivery of the Inland Revenue Account whether that is before the due date or not.

If tax is paid late, interest is payable, regardless of the reason for late payment.

If an election is made to pay tax by instalments on

- shares in unquoted companies
- business or partnership interests
- land and buildings

the first instalment is payable on the due date and the remaining instalments are payable on successive anniversaries of the first payment. Interest is payable on the outstanding instalments after the due date.

The rate of interest has fluctuated over the years so the calculation is made on a daily basis according to the rate applicable on any given date. The rates for the last number of years are as follows:

Interest Period	Days	Rate
06.11.01 to 05.08.03	638 days	3%
06.08.03 to 05.12.03	122 days	2%
06.12.03 to 05.09.04	275 days	3%
06.09.04 to 05.09.05	365 days	4%
06.09.05 to 05.09.06	365 days	3%

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06.09.06 to 05.08.07	334 days	4%
06.08.07 to 05.01.08	153 days	5%
06.01.08 to		4%

### Partly Exempt Transfers on Death

#### (1) Specific bequests with exempt residuary beneficiaries

A specific gift is anything other than a share of the residuary estate.

Where the Testator bequeaths a Specific Gift 'free of inheritance tax', to a non-exempt individual, and leaves residue to an exempt body or individual (e.g. a charity or a spouse), the tax on the specific gift is found by 'grossing up' and is paid out of the residuary estate.

The grossing up rates from 15 March 1988 onwards are as follows:

Rate on net transfers Fraction	
1. Net Transfers on death not paying their own tax	
Up to Nil Rate Band	Nil
Excess over Nil Rate Band	2/3
2. Net Lifetime Transfers	
Up to Nil Rate Band	Nil
Excess over Nil Rate Band	1/4

#### Example:

Mr Brown dies on 30 July 2008 leaving an estate worth £500,000. In his Will, Mr Brown bequeathed his brother Jack a tax free cash legacy of £330,000 and left the rest of his estate to a local charitable organisation.

Tax free legacy to Jack	£330,000.00
Tax on the Legacy	(£330,000 - £312,000 x 2/3) £12,000.00
Gross Legacy	<b>£342,000.00</b>
Estate	£500,000.00
Legacy to Jack	£330,000.00
IHT on Legacy	£12,000.00
Residue to Charity	<b>£158,000.00</b>

#### (2) Specific bequests with mixed residue ('Double Grossing Up')

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If the specific gifts are not the only chargeable bequests, complicated rules must be followed in order to allocate the values to the exempt and non exempt parts of the residuary estate.

### Example:

Mr Bloggs died on the 11 July 2008 leaving an estate valued at £1,000,000. After bequeathing a legacy of £330,000 'free of tax' to his granddaughter Margaret and a legacy of £15,000 'subject to tax' to his cousin Robert, he left the residue of his estate equally between a local charity and his son Percy.

### 1. Calculate total gross legacies, residue and hypothetical chargeable estate:

Tax free gift to granddaughter		£330,000.00
Tax on Legacy (£330,000 - £312,000 x 2/3)		£12,000.00
Legacy to Robert		£15,000.00
Total Gross Legacies		<b>£357,000.00</b>
Gross Value of Estate	£1,000,000.00	
Less Total Gross Legacies	(£357,000.00)	
Residue	643,000.00	
Half of Residue to Percy (tax chargeable)		£321,500.00
Total Gross Legacies (tax chargeable)		£357,000.00
Hypothetical Chargeable Estate		<b>£678,500.00</b>

### 2. Calculate assumed rate of tax on tax-free legacy:

Hypothetical Chargeable Estate	£678,500.00
Less Nil Rate Band	(£312,000.00)
	<b>£366,500.00</b>
Tax at 40% of £366,500.00	£146,600.00

Assumed Rate =  $\frac{£146,600}{£678,500} \times 100 = 21.6065\%$

### 3. Re-gross tax free legacy using assumed rate:

£330,000 x $\frac{100}{(100 - 21.6065\%)}$	£420,953.00
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### 4. Re-calculate hypothetical chargeable estate using grossed up tax-free legacy figure:

Grossed up tax free legacy		£420,953.00
Legacy paying own tax		£15,000.00
Grossed up legacies		<b>£435,953.00</b>
Gross Value of Estate	£1,000,000.00	
Grossed up legacies	(£435,953.00)	
Residue		<b>£564,047.00</b>
Half share of Residue to Percy		£282,023.50
Recalculated Hypothetical Chargeable Estate (Percy's share of residue + Grossed up legacies)		<b>£717,976.50</b>

### 5. Calculate tax on recalculated hypothetical chargeable estate and estate rate of tax:

Tax on Hypothetical Chargeable Estate:  $(£717,976.50 - £312,000 \times 40\%) = £162,390.60$

**Estate Rate** =  $£162,390.60 / £717,976.50 \times 100 = 22.6178\%$

### 6. Estate distribution:

Cash gift to Margaret	£330,000.00
Cash gift to Robert	£15,000.00
Tax on gift to Margaret (at assumed rate of 22.6178% on £435,953.00)	£98,603.00

**Specific Gifts and Tax thereon** **£443,603.00**

Gross Estate	£1,000,000.00
Less Specific Gifts and Tax thereon	(£443,603.00)
Residue	£556,397.00

### 7. Allocation of estate:

One half of Residue to Charity		£278,198.50
One half of Residue to Percy	£278,198.50	
Less Tax thereon at 22.6178%	(£62,922.40)	£215,276.10
Legacy to Margaret		£330,000.00
Legacy to Robert	£15,000.00	
Less Tax thereon at 22.6178%	£3,392.70	£11,607.30
Tax Borne by Residue		
(Tax on Percy's share of residue and on Margaret's tax-free gift)		£161,525.40
Tax on gift to Robert		£3,392.70
		<b>£1,000,000.00</b>

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