These notes are intended as a guide only and we recommend anyone reading these notes always to take professional advice in specific cases, and not to act solely in reliance on the notes.

**What is Inheritance Tax?**

Inheritance Tax (IHT) is payable on the value of a person's estate when they die. It used to be known as Capital Transfer Tax and, more colloquially, as death duty.

**Who is liable?**

The estates of individuals domiciled in the UK are liable to Inheritance Tax on their worldwide assets. Individuals domiciled elsewhere are liable to IHT only on their assets situate in the UK.

Note: It is the estate of the deceased that is liable, not the individual beneficiary. Thus it is one of the Executors' responsibilities to ensure that IHT is correctly paid.

Nevertheless, in the notes that follow, the deceased person may be referred to as the 'transferor', as death marks a transfer of the assets from his or her ownership to others, regardless of when physical transfer to the beneficiaries takes place. In addition, the deceased may have transferred assets prior to death which may affect the calculation of IHT.

**Domicile**

If the individual is domiciled outside of the UK, it is important to understand where assets are treated as being located to know what will be within the charge to IHT:

- Land and chattels - where physically located
- Bank Accounts - the branch where the account is held
- Stocks and shares - where they are registered. If they are transferable in more than one country then they are situate in the country they are most likely to be dealt with.
- Bearer Securities – in the country in which the certificate is held.
Where tax starts - The Nil Rate Band

Each individual (regardless of domicile) is entitled to a Nil Rate Band. This is a great piece of Revenue-speak: The first part of the estate value is taxed, but at 0% - i.e. no tax. The level of the Nil Rate Band in 2008/2009 is £312,000. Below are the Nil Rate Bands for recent years (see also www.ilmnet.org - Members' Section - Directory of Resources, for past rates and future changes).

<table>
<thead>
<tr>
<th>Year</th>
<th>Band</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999/00</td>
<td>£231,000</td>
</tr>
<tr>
<td>2000/01</td>
<td>£234,000</td>
</tr>
<tr>
<td>2001/02</td>
<td>£242,000</td>
</tr>
<tr>
<td>2002/03</td>
<td>£250,000</td>
</tr>
<tr>
<td>2003/04</td>
<td>£255,000</td>
</tr>
<tr>
<td>2004/05</td>
<td>£263,000</td>
</tr>
<tr>
<td>2005/06</td>
<td>£275,000</td>
</tr>
<tr>
<td>2006/07</td>
<td>£285,000</td>
</tr>
<tr>
<td>2007/08</td>
<td>£300,000</td>
</tr>
<tr>
<td>2008/09</td>
<td>£312,000</td>
</tr>
<tr>
<td>2009/15</td>
<td>£325,000</td>
</tr>
</tbody>
</table>

However, the Nil Rate Band available at death is reduced by gifts made within the seven years before death.

Any part of the Nil Rate Band which is unused on death (e.g. the transfer was exempt as all assets were transferred to their spouse) can be transferred to the deceased person’s spouse or civil partner. The spouse or civil partner’s Nil Rate Band will then be increased by this unused amount on the spouse or civil partner’s own death, as long as this second death was after 9 October 2007.

The Rate of tax

For assets in excess of £325,000 the rate of tax is 40%.

Exemptions from IHT

Some of the exemptions from IHT that you are likely to encounter include:

1. Gifts to Spouse - the exemption is 100%.
2. Gifts to Registered Charities - again 100%. This does not include foreign charities.
3. Gifts to National Purposes - e.g. gifts to the British Museum
4. Gifts to Political Parties
5. Transfers of agricultural and business property, which may qualify for relief at either of 50% or 100%

Where the Burden of IHT falls

Unless there is a contrary intention in the Will, IHT on property which vests in the personal representatives is treated as part of the general funeral and testamentary expenses of the
estate (Section 211 IHTA 1984). That is, like funeral and testamentary expenses, IHT is borne by residue.

Thus those who receive pecuniary and specific gifts do not bear the tax on those gifts (unless the Will stipulates otherwise, and it rarely does). That is, the liability will normally fall on the Residuary Estate. But what happens where the IHT comes about because of large pecuniary or specific gifts and part or all of residue is left to charities - which are exempt?

**Who bears the tax on those gifts?**

In that situation, the IHT is deducted from the whole of residue and all the beneficiaries bear it pro-rata to their share of residue. Many people are confused by this seemingly contradictory situation as it appears that the exempt body has to pay IHT. In effect, the Revenue treats the non-exempt gift as comprising both the gift and the tax on it. The calculation of the tax requires a procedure called 'grossing up', covered in a separate ILM factsheet on IHT calculations:

**‘Advanced Inheritance Tax’.**

Gifts of shares of residue are different. Here the IHT is borne by the non-exempt residuary beneficiaries only. This is a requirement of Section 41(b) of the 1984 Inheritance Tax Act which says, to put it in plain English: Where the residue of an estate is partly exempt and partly taxable, the taxable share of residue bears its own tax. If you are checking through some estate accounts where there is IHT on residue and residue is shared between charities and, say family members, look out for this: the value of what the charities receive should be different from what the family members receive. If everybody is getting the same amount, there is probably a mistake. Either that or the Executors are maintaining that this is a Benham calculation (see below).

Where IHT comes about through both pecuniary/specific gifts and gifts of shares of residue to non-exempt beneficiaries, the calculation requires a procedure called 'double grossing-up', also covered in the ILM factsheet mentioned earlier.

**Benham and Ratcliffe**

In 1995 a case was brought concerning the distribution of the estate of a Miss Benham. In an unusually-worded Will, she had left residue in two parts, effectively between charities and private individuals. The judge ruled that the charities and the individuals should receive equal amounts after appropriate tax had been deducted. This (a) appeared to cost all for more tax to be paid to the Revenue and (b) seemed to flout the provisions of S41(b) 1984 IHTA mentioned above. Happily, another case was brought by a number of charities a while later (Re: Ratcliffe) which made it clear that where the usual wording regarding division of residue was used, the Benham calculation did not apply. What this means is that where residue is simply divided into parts, charities do not bear any IHT on residue. For the Benham calculation to apply, very specific wording must be used in the Will to say what each class of beneficiary should receive only after IHT has been applied to their net benefit.
Will Trusts

Where a Will creates a trust, responsibility for paying the IHT on the trust value falls on the Trustees. As it happens, these are usually the same as the Executors of the estate. If capital is held for charities after the death of the life-tenant (the income beneficiary), then shouldn't the gift be exempt? Unfortunately not. At the testator's death the capital is deemed to be transferred for the benefit of the life-tenant and is taxable. What is more, when the life-tenant dies, that capital is deemed to be his/hers and is added to his or her own estate.

Deeds of Variation and IHT

A charity may be left an estate which includes property recently inherited which has borne IHT. If 'recently inherited' means that the two deaths are within two years, then it may be possible to redirect the inherited property to the charity and so avoid the IHT that would otherwise be payable. Thus it is always worth looking out for estates that have benefited from a previous estate and asking (a) if IHT was borne on the first estate and (b) if the deaths were less than two years apart. But note firstly that any Deed of Variation must be executed before 2 years from the first death and secondly, you will be hard put to sue a solicitor who neglects to mention these facts. It's been tried.