

## CHAPTER 4

### LIFETIME TRANSFERS - "GROSSING UP"

#### 4.1 Who pays the inheritance tax?

So far we have calculated inheritance tax on chargeable transfers using the lifetime rate of 20%, on the assumption that the **tax was paid by the trustees**. In fact, **primary responsibility** for paying any lifetime inheritance tax **rests with the donor**. However the donor may, if he wishes, delegate responsibility for paying the tax to the trustees.

The IHT rate which applies to lifetime transfers is 20%. However, if the **donor agrees to pay** the inheritance tax, this rate of 20% must be "**grossed up**". Where the donor pays the lifetime inheritance tax instead of using a rate of 20% we use the grossed up rate of  $\frac{20}{80}$ ths.

This reflects the fact that the loss to the donor's estate as a result of the transfer, is not only the gift to the discretionary trust but also the tax that is paid to HMRC.

#### Illustration 1

George has £1 million in cash and wishes to transfer this to a discretionary trust. All of George's nil band and annual exemptions have been used on previous chargeable transfers. George can create this discretionary trust in two different ways.

1. He could transfer £1 million into the discretionary trust and ask the trustees to meet any lifetime inheritance tax. With a lifetime rate of 20%, the trustees would pay IHT of £200,000 leaving a balance of £800,000 in the trust.

This is how we calculated IHT in the previous chapter, i.e. by assuming the trustees paid the tax and using a lifetime rate of 20%.

George could achieve the same result in a slightly different way.

2. George could transfer £800,000 to the trust and agree to pay the tax himself. George would pay £200,000 in IHT to HMRC, leaving a balance of £800,000 in the trust. Once again, HMRC receive £200,000 in inheritance tax, whilst the trustees receive a net amount of £800,000.

However under the second route, in order to calculate the inheritance tax payable by the donor, we take the net transfer of £800,000 and multiply by the grossed up rate of  $\frac{20}{80}$ ths.

Therefore in lifetime IHT computations where the donor pays the tax, instead of using the normal life rate of 20%, we will be using the grossed up rate of  $\frac{20}{80}$ .

## 4.2 Calculating IHT due

We follow the same procedure as laid out in the previous chapter - i.e. we **take the gift, deduct annual exemptions, then work out the nil band remaining**. However, when calculating the tax we use the grossed up rate. In law, primary responsibility for paying the tax rests with the donor, so if the donor does not delegate that responsibility, **IHT is calculated using the grossed-up rate**.

## 4.3 Cumulation

When we look back 7 years to identify previous chargeable lifetime transfers, we always identify the **gross amount** of the transfer. The **gross gift** is the **value transferred, plus any tax paid** on the transfer by the donor. In the previous example, George paid £800,000 into the trust, and to that we would add the tax of £200,000 to give a gross chargeable transfer of £1 million. This is the amount on the donor's "clock" for cumulation purposes.

### Illustration 2

In August 2004 William made a cash gift of £281,000 to a discretionary trust. In July 2010, William added a further £91,000 to the discretionary trust. Dealing with annual exemptions first:

<i>August 2004</i>		<i>July 2010</i>	
	£		£
Gift	281,000	Gift	91,000
Less: AE 2004/05	(3,000)	Less: AE 2010/11	(3,000)
Less: AE 2003/04	<u>(3,000)</u>	Less: AE 2009/10	<u>(3,000)</u>
CLT	<u>275,000</u>	CLT	<u>85,000</u>

We will calculate the inheritance tax on both transfers assuming that William agrees to pay the tax on both occasions.

Starting with the tax on the August 2004 transfer.

	£	£
CLT		275,000
Nil band 2004/05	263,000	
Less: chargeable transfers in previous 7 years	<u>Nil</u>	
Nil band remaining		<u>(263,000)</u>
Taxable		<u>12,000</u>
IHT @ $\frac{20}{80}$ (paid by donor)		<u>£3,000</u>

William's chargeable lifetime transfer in August 2004 was £275,000. However William also paid IHT of £3,000. Therefore the total loss to his estate as a result of the transfer is £278,000. William's gross chargeable transfer is the net amount of £275,000 plus the tax paid thereon.

	£
Chargeable lifetime transfer (net)	275,000
Add: tax paid by donor	<u>3,000</u>
Gross chargeable transfer	<u>278,000</u>

This gross chargeable transfer figure is relevant for the purposes of 7 year cumulation.

Turning now to the chargeable lifetime transfer in July 2010:

	£	£
Chargeable lifetime transfer		85,000
Nil band 2010/11	325,000	
Less: chargeable transfers in previous 7 years	<u>(278,000)</u>	
Nil band remaining		<u>(47,000)</u>
Taxable		<u>38,000</u>
IHT @ $\frac{20}{80}$ (paid by donor)		<u>£9,500</u>

The gross transfer in July 2010 is therefore the CLT of £85,000 plus the tax paid by William, i.e. £94,500. This gross figure will be carried forward for cumulation purposes.

	£
Chargeable lifetime transfer	85,000
Add: tax paid by donor	<u>9,500</u>
Gross chargeable transfer	<u>94,500</u>

#### 4.4 Transfers made on the same day

We usually deal with transfers in chronological order.

Annual exemptions are set against earlier gifts in priority to later gifts in the tax year. However where two transfers are made on the same day, the **annual exemption is apportioned between the transfers**.

[IHTA 1984, s. 19\(3\)\(b\)](#)

As far as calculating IHT is concerned, there is a potential problem if the donor makes two chargeable lifetime transfers on the same day, and he agrees to pay the tax himself on one of the gifts, but on the other he delegates that responsibility to the trustees.

For IHT purposes we need to know which transfer was made first.

In this situation the **gift on which the donor pays the tax is treated as having been made first**, as this will result in less inheritance tax being payable.

[IHTA 1984, s. 266\(1\)](#)

#### Illustration 3

On 12 March 2011, Mary creates two trusts. Mary has made no other lifetime gifts, so all annual exemptions and the full nil band are available.

Mary gives £800,000 to the Alpha trust, and £400,000 to the Beta trust. Mary has annual exemptions for the current year and for the preceding year totalling £6,000. Where two transfers are made on the same day, the annual exemption must be apportioned between the gifts.

<i>Alpha Trust</i>		<i>Beta Trust</i>
£		£
800,000	Gift	400,000
<u>(4,000)</u>	Less: AEs	<u>(2,000)</u>
<u>796,000</u>	CLTs	<u>398,000</u>

As the trusts are created after March 2006, both gifts are chargeable lifetime transfers.

The trustees of the Alpha trust will pay the tax on the CLT of £796,000. Mary agrees to pay the tax on the CLT of £398,000 to the Beta trust.

For IHT purposes, the gift to the Beta trust is treated as having been made first, followed by the gift to the Alpha trust. We will therefore calculate two separate IHT charges, and do the calculations in this order.

Dealing with the transfer to the Beta trust first.

	£	£
CLT to Beta Trust		398,000
Nil band 2010/11	325,000	
Less: chargeable transfers in previous 7 years	<u>Nil</u>	
Nil band remaining		<u>(325,000)</u>
Taxable		<u>73,000</u>
IHT @ $\frac{20}{80}$ (paid by donor)		<u>£18,250</u>
		£
Chargeable lifetime transfer		398,000
Add: tax paid by donor		<u>18,250</u>
Gross chargeable transfer		<u>416,250</u>

Next we calculate IHT on chargeable lifetime transfer of £796,000 to the Alpha trust.

	£	£
Chargeable lifetime transfer		796,000
Nil band 2010/11	325,000	
Less: chargeable transfers in previous 7 years	<u>(416,250)</u>	
Nil band remaining		<u>Nil</u>
Taxable		<u>796,000</u>
IHT @ 20% (paid by trustees)		<u>£159,200</u>

As the transfer to the Beta Trust uses up the whole of the nil band, the CLT of £796,000 is fully chargeable to inheritance tax. As this tax will be met by the trustees, we use the normal lifetime rate of 20%.

### Example 1

Celia made the following lifetime gifts:

May 2000	£100,000 to Discretionary trust No. 1
July 2004	£181,000 to Discretionary trust No. 2
March 2011	£180,000 to interest in possession trust

Celia paid any IHT due.

**Calculate the IHT payable on the gift to the interest in possession trust in March 2011.**

**Answer 1**

(i) Gift to discretionary trust no. 1 (May 2000):

	£
Gift	100,000
Less: AE 2000/01	(3,000)
Less: AE 1999/00	<u>(3,000)</u>
CLT	94,000
Nil band 2000/01 (fully available)	<u>(234,000)</u>
Taxable	<u>Nil</u>
No lifetime tax due	

(ii) Gift to discretionary trust no. 2 (July 2004):

		£
Gift		181,000
Less: AE 2004/05		(3,000)
Less: AE 2003/04		<u>(3,000)</u>
CLT		175,000
Nil band 2004/05	263,000	
Less: chargeable transfers in previous 7 years	<u>(94,000)</u>	
Nil band remaining		<u>(169,000)</u>
Taxable		<u>6,000</u>
IHT @ $\frac{20}{80}$ (paid by donor)		<u>£1,500</u>

	£
Chargeable lifetime transfer	175,000
Add: tax paid by donor	<u>1,500</u>
Gross chargeable transfer	<u>176,500</u>

(iii) Gift to interest in possession trust (March 2011)

		£
Gift		180,000
Less: AE 2010/11		(3,000)
Less: AE 2009/10		<u>(3,000)</u>
CLT		174,000
Nil band 2010/11	325,000	
Less: chargeable transfers in previous 7 years (July 2004 only)	<u>(176,500)</u>	
Nil band remaining		<u>(148,500)</u>
Taxable		<u>25,500</u>
IHT @ $\frac{20}{80}$ (paid by donor)		<u>£</u> <u>6,375</u>

*Note:* gift to IIP trust after 22.3.06 is a CLT