CHAPTER 6

ADDITIONAL TAX ON DEATH

6.1 Charges on death

On the death of an individual, there are **three types of transfer** which are chargeable to inheritance tax.

First any **potentially exempt transfers** made by the deceased **in the 7 years prior to his death** will become chargeable to inheritance tax. Any tax on these "failed" PETs is payable by the recipient of the gift – i.e. **by the donee.** IHTA 1984, Sch 1 para 1A

If the deceased had made any **chargeable lifetime transfers in the 7 years prior to his death, additional tax** may be payable on these transfers. There is no additional tax on chargeable transfers which were made more than 7 years before the donor's death. If the donor dies within 7 years of making a chargeable lifetime transfer, any extra tax will be **paid by the trustees**. IHTA 1984, Sch 1 para 2

Finally when an individual dies, he is deemed to have made a chargeable transfer equal to the value of the **assets in his death estate**. In this chapter we shall concentrate on PETs and CLTs in the 7 years prior to the death of the donor. IHTA 1984, s.4

When calculating IHT as a result of death, the **tax rate is always 40%.** IHTA 1984, Sch 1

6.2 Death tax on potentially exempt transfers

A PET will become a chargeable transfer if the donor dies within 7 years of the gift. When calculating tax on these PETs, we **use the nil band and the IHT rates in force at the date of death.** IHTA 1984, Sch 1 para 1A

However, do not forget that inheritance tax is a cumulative tax. Therefore to work out the amount of the **nil band which is remaining, we must deduct any gross chargeable transfers in the 7 years before the PET**. This will give us the remaining nil band which will help us calculate the inheritance tax due.

Note that when calculating the nil band available, we **look back 7 years from the date of the potentially exempt transfer**. We do not simply look back 7 years from death.

Therefore chargeable transfers made by the donor more than 7 years before death, may have to be taken into account to calculate the remaining nil band. This will be illustrated in the examples which follow.

Finally tax payable on potentially exempt transfers is payable by the donee. The due date for the tax is always **6 months from the end of the month in which the donor died.**

Illustration 1

In May 2002 Andrew made a chargeable transfer (after annual exemptions) of £152,000.

In July 2008 Andrew gave £216,000 to his son. After deducting two annual exemptions, Andrew made a potentially exempt transfer of £210,000. Andrew died in August 2010. The PET in July 2008 now becomes a chargeable transfer. We therefore need to calculate the tax payable by Andrew's son on this PET as a result of his father's death.

We start with the nil band for the year of death which is £325,000. We look back 7 years from the PET to see if Andrew had made any chargeable transfers in that period. We therefore look back from July 2008 to July 2001. The chargeable transfer in May 2002 therefore needs to be taken into account as it was within 7 years of the PET.

	£	£
PET (now chargeable)		210,000
Nil band at death (2010/11)	325,000	
Less: chargeable transfers in 7 years before PET (July 2001-July 2008)	(152,000)	
Nil band remaining		(173,000)
Taxable on death		37,000
IHT @ 40% (paid by son)		£14,800

Note in this example that the chargeable transfer in May 2002 has not been charged to IHT at Andrew's death, as there are more than 7 years between the date of the gift and the date of death. However, this chargeable lifetime transfer has been taken into account when working out the tax on the PET.

6.3 Taper relief

IHTA 1984, s.7(4)

IHT taper relief is given where there are **more than three years between the date of the potentially exempt transfer and the death of the donor.**

Taper relief **reduces the tax payable** by a certain percentage.

That **percentage depends on the time period** between the date of the gift and the date of death.

Note here that taper relief reduces the **tax payable** – it does not reduce the amount of the transfer.

The taper relief percentages are given below:

Length of time between date of gift and date of death	%
0-3 years	Nil
3-4 years	20
4-5 years	40
5-6 years	60
6-7 years	80

These percentages are also reproduced in your tax tables.

You will see from the table that if there are **less than 3 years between the date of gift and the date of death, no taper relief is available**. Taper relief reduces the tax by either 20%, 40%, 60% or 80%, increasing as each year passes.

Where there are more than 7 years between the date of the gift and the date of death, the potentially exempt transfer becomes completely exempt, so in effect the tax is reduced by 100%.

Illustration 2

In May 2003, Marion made a chargeable transfer (after exemptions) of £139,000. In July 2004, Marion gave £209,000 to her son. An annual exemption is available for 2004/05, but the exemption for the previous year has been used against the gift in May 2003.

	£
Gift (July 2004)	209,000
Less: AE 2004/05	(3,000)
PET	206,000

In December 2010 Marion gave £177,000 to her daughter.

	£
Gift (December 2010)	177,000
Less: AE 2010/11	(3,000)
Less: AE 2009/10 b/fwd	(3,000)
PET	171,000

Marion died in March 2011. We therefore need to look at Marion's lifetime transfers and identify the inheritance tax charges arising;

(i) Gift to discretionary trust (May 2003)

There will be no additional tax payable on this gift as there are more than 7 years between the date of gift and the date of death.

(ii) PET (July 2004)

The PET made by Marion in July 2004 now becomes a chargeable transfer because it is made within 7 years of death. However, because there are more than 3 years between the date of gift and the date of death, any death tax can be reduced by taper relief.

	£	£
PET (July 2004)		206,000
Nil band at death (2010/11)	325,000	
Less: chargeable transfers in 7 years before July 2004	(139,000)	
Nil band remaining		(186,000)
Taxable on death		20,000
IHT @ 40%		£8,000

At this point we consider taper relief. To calculate the taper relief we measure the distance between the date of the PET (July 2004) to the date of death in March 2011.

The period between gift and death is around 6½ years, giving a taper relief percentage of 80%. We therefore remove 80% of the tax of £8,000.

	£
IHT (as above)	8,000
Less: taper relief (6-7 years = 80%)	(6,400)
Tax payable by donee (son)	£1,600

The PET in December 2010 is also chargeable to inheritance tax on Marion's death. No taper relief will be available to reduce the death tax as there are less than 3 years between the date of this gift and the date of Marion's death.

(iii) PET (December 2010)

	£	£
PET (December 2010)		171,000
Nil band at death (2010/11)	325,000	
Less: chargeable transfers		
in 7 years before December 2010		
(i.e. PET July 2004)	(206,000)	
Nil band remaining		(119,000)
Taxable on death		52,000
IHT @ 40%		£20,800
Payable by donee (daughter)		

Note that the PET of £206,000 in July 2004 is now a chargeable transfer so it must be considered for cumulation purposes.

The chargeable transfer in May 2003 can be ignored as it is more than 7 years before the PET.

6.4 Additional tax on chargeable lifetime transfers

IHTA 1984, Sch 1 para 2

If an individual makes a **gift into a discretionary trust** (or to an interest in possession trust after 22 March 2006), it will be **immediately chargeable** to lifetime inheritance tax.

If the donor **dies within 7 years** of making that gift, there will **be additional tax** on death. This death tax is paid by the trustees.

The way we calculate this additional tax is very similar to the procedure we use for calculating tax on potentially exempt transfers. We start with the CLT, then calculate the amount of the nil band remaining to leave a transfer chargeable to inheritance tax. Tax is charged on the trustees at the **death rate of 40%.**

As is the case for PETs, if there are more than 3 years between the date of the chargeable lifetime transfer and the date of death, **taper relief will be available** to reduce this tax.

The only difference in the calculation of tax on CLTs and tax on PETs, is that the trustees will receive **credit for any lifetime tax paid** on the chargeable lifetime transfer. The difference between the death tax and the lifetime tax paid is the additional tax payable by the trustees.

This process of giving credit for lifetime tax paid ensures that there is no element of double taxation. If **lifetime tax exceeds tax on death**, the Revenue **will not allow any tax repayment**. In this instance, the additional tax on death will simply be reduced to zero.

Illustration 3

In May 2002 Joanne made a potentially exempt transfer of £50,000. For the purpose of this example we will ignore annual exemptions.

Joanne made a chargeable lifetime transfer of £645,000 in June 2006.

In March 2008, Joanne made another potentially exempt transfer, this time of £40,000. Joanne died in November 2010. We will calculate both the lifetime tax, and any tax payable as a result of Joanne's death.

(i) Lifetime tax on CLT (June 2006)

In examples such as these, always start by calculating the lifetime tax on any chargeable lifetime transfers.

	£	£
CLT (June 2006)		645,000
Nil band at gift	285,000	
Less: chargeable transfers in previous 7 years	Nil	
Nil band remaining		(285,000)
Taxable		360,000
IHT @ 20% (assume trustees pay tax)		£72,000

Note here we have ignored the PET in May 2002, because at this point the PET is not a chargeable lifetime transfer.

Having calculated the lifetime tax, we move on and deal with the death tax. With all death tax computations, the first thing to do is to look back 7 years from the date of death and identify transfers in that period.

We therefore look at all gifts made by Joanne in the period from November 2003 until her death in November 2010.

(ii) PET (May 2002)

The PET in May 2002 is more than 7 years before Joanne's death and is therefore an exempt transfer. As Joanne survived 7 years from this gift, this PET has become exempt and may now be completely ignored.

(iii) CLT (June 2006)

The chargeable lifetime transfer in June 2006 is within 7 years of death, therefore extra tax may be payable by the trustees.

	£	£
CLT (June 2006)		645,000
Nil band at death (2010/11)	325,000	
Less: chargeable transfers		
in 7 years before June 2006	Nil	
Nil band remaining		(325,000)
Taxable on death		£320,000

As the PET in May 2002 is now an exempt transfer it can be disregarded. The full nil band of £325,000 is therefore available.

Taxable on death	320,000
IHT @ 40%	128,000
Less: taper relief (4-5 years = 40%)	(51,200)
	76,800
Less: credit for lifetime tax	(72,000)
Extra tax payable by trustees	4,800

This additional tax is due 6 months from the end of the month of death, i.e. on 31 May 2011, and is payable by the trustees.

(iv) PET (March 2008)

This is chargeable on death.

	£	£
PET (March 2008)		40,000
Nil band at death	325,000	
Less: chargeable transfers in 7 years		
before March 2008 (i.e. CLT June 2006)	(645,000)	
Nil band remaining		Nil
Taxable on death		40,000
IHT @ 40% (no taper relief available)		£16,000

When calculating death tax on different lifetime transfers, it is very common to find that by the time you get to the final lifetime transfer, the previous chargeable transfers have used up the whole of the nil band.

Very often therefore, the final chargeable transfer will be fully taxed at 40% as is the case in this example.

Example 1

Jeremy made the following lifetime transfers:

March 1998	Gift to discretionary trust	£150,000
July 2004	Gift to brother Joe	£225,000

Jeremy died in August 2010.

Calculate the tax payable by Joe as a result of Jeremy's death.

Example 2

Geoffrey gave a house worth £400,000 to his best friend Peter in June 2010. Geoffrey died in September 2010.

Which of the following statements is true?

a) No IHT is payable as the gift was a PET
b) Inheritance tax is payable by Geoffrey's Executors on 31 March 2011.
c) Inheritance tax is payable by Peter on 31 March 2011.
d) Inheritance tax is payable by Peter on 30 April 2011.

Answer 1

(i) Gift to discretionary trust (March 1998):

	£
Gift	150,000
Less: AE 1997/98	(3,000)
Less: AE 1996/97	(3,000)
CLT	144,000
No lifetime tax as < nil band	

(ii) Gift to brother (July 2004)

	£
Gift	225,000
Less: AE 2004/05	(3,000)
Less: AE 2003/04	(3,000)
PET (no lifetime tax)	219,000

PET chargeable as within 7 years of death.

Death tax:

	£	£
PET (July 2004)		219,000
Nil band at death	325,000	
Less: chargeable transfers in 7 years before PET (CLT March 1998)	(144,000)	
Nil band remaining		(181,000)
Taxable on death		38,000
IHT @ 40%		15,200
Less: taper relief (6-7 years = 80%)		(12,160)
Tax payable by donee (Joe)		**£3,040**

Note:
Although the CLT in March 1998 is not itself charged to tax on death, it has had to be considered when calculating tax on the PET.

Answer 2

The answer is ***C***

Original gift = PET – no lifetime tax
PET becomes chargeable when Geoffrey dies in September 2010
Death tax paid by Donee – i.e. Peter.
Tax due 6 months from end of month of death

30 September 2010 + 6 months = 31 March 2011