

CHAPTER 11

THE DEATH ESTATE

11.1 Introduction

When a taxpayer dies there are **3 potential charges** to inheritance tax as a result of his death.

If a donor dies, any **potentially exempt transfers** he has made in the previous 7 years become chargeable. In addition, extra tax may be charged on **chargeable lifetime transfers** in the 7 years prior to death. In both instances, the tax is payable by the donee - i.e. by the recipient of the PET or by the trustees of the discretionary trust.

In this session we will look at how we calculate inheritance tax on the **death estate**. By "death estate" we mean the **net value of all the assets owned by the deceased at the date of death**. "Net value" means the total value of all the **assets less any debts or liabilities** owed by the individual at the date of death. Tax on the death estate is paid by the Executors of the deceased. Executors are also called Personal Representatives (PRs).

[IHTA 1984,
s.5](#)

11.2 Duties of Executors

When an individual dies, the **assets in his estate will pass to his Executors**. The deceased will appoint Executors in his Will. If an individual dies without a valid Will, he is said to have died "intestate". In this case, Personal Representatives will be appointed by the Court. These are called "administrators". It is common for a testator to appoint 2 Executors within his Will, although there is no legal reason why less or more Executors could not be appointed.

The primary duties of an Executor fall into 4 main areas.

1. One of the first duties for the Executors is to obtain "probate". "Probate" is the formal **process by which the Executors obtain legal title to the assets of the deceased**. Probate is obtained by application to the Probate Registry or to the High Court. Once an Executor has obtained probate, he is free to deal in the assets of the deceased.
2. Once he has probate, the Executor must **determine and collect the assets of the deceased**.
3. The Executor must **deal with HMRC**. First, the Executor must prepare the **income tax return** for the period from 6 April until the date of death. In doing so, the Executor will calculate any income tax or any capital gains tax due or repayable for the year of death and previous years.

The Executor must also prepare an **inheritance tax return** (form IHT 400). The IHT 400 will contain details of the **net assets** of the deceased at the date of death, together with any **transfers he had made in the previous 7 years**. Having calculated the tax on the death estate, the Executors will **pay this tax** to HMRC.

4. Finally an Executor will **distribute the estate in accordance with the terms of the will or under the rules of intestacy**. Within his will, the donor would have specified who should benefit from his estate, and the Executors will distribute his assets to these nominated beneficiaries.

11.3 Calculating the inheritance tax

At the point of death, the deceased is treated as having made a **chargeable transfer equal to the net value of all of his assets at the date of death**. The starting point is therefore to calculate the net value of the estate. We shall look at how we do this in more detail in the next chapter.

[IHTA 1984,
s.4](#)

The way we calculate IHT on the death estate is very similar to the process we used for calculating death tax on lifetime transfers. We start with the nil band for the year of death. As IHT is a cumulative tax, the nil band is reduced by any chargeable transfers (PETs or CLTs) in the 7 years prior to death.

We deduct the nil band remaining to leave the amount of the death estate that is chargeable to IHT. Tax is charged at the death rate of 40%. When calculating tax on the death estate, it is common to find that PETs and CLTs in the 7 years prior to death have used up the whole of the nil band. On many occasions therefore, the whole of the death estate is fully charged at 40%.

[IHTA 1984,
Sch 1](#)

11.4 Due dates

The inheritance tax is payable by the Executors 6 months from the end of the month of death. Therefore if an individual dies in March 2011, the tax is payable no later than 30 September 2011.

[IHTA 1984,
s.226](#)

However, if the Executors file the inheritance tax return before the statutory due date for paying the tax, any IHT becomes payable at the point the return is submitted.

Interest will be charged if tax is paid late. However, interest will only start to run 6 months from the end of the month of death.

11.5 Exempt transfers

Having arrived at the total value of the deceased's estate, we **remove any exempt transfers to leave the chargeable death estate**. If an individual makes a gift to his spouse on death, this gift is completely exempt.

The spouse exemption is restricted to £55,000 if the recipient spouse is not domiciled in the UK. This exemption is reduced by any lifetime gifts to the non-domiciled spouse.

[IHTA 1984,
s.18](#)

Gifts to UK charities on death are also completely exempt, as are gifts to political parties, housing associations or national heritage bodies.

[IHTA 1984,
s.23 - s. 25](#)

The annual exemption of £3,000 applies to **lifetime transfers only**, and it **does not reduce the value of the chargeable death estate**. Annual exemptions are only given against "inter-vivos" gifts, i.e. gifts which take place while the donor is still alive.

[IHTA 1984,
s.19](#)

There is no IHT charge on "excluded property" within the death estate. The most common example of excluded property is **non UK assets owned by an individual who is not domiciled in the UK**. The amount of any excluded property should be removed from the chargeable estate before tax is applied.

[IHTA 1984,
s.6](#)

Where a person dies whilst on active service as a member of the British Armed Forces, **his/her death estate is not charged to IHT**. The death will, however, trigger an IHT liability in respect of any PETs or CLTs in the previous 7 years.

[IHTA 1984,
s.154](#)

The pay and tangible movable property of members of **overseas Armed Forces stationed in the UK is also exempt** from IHT. This exemption will primarily apply to assets such as furniture and cars etc (not land or shares) which is in the UK solely by reason of the member's duty here. The exclusion is **not** available to spouses, civil partners or other dependants of qualifying persons.

[IHTA 1984,
s.155](#)

Illustration 1

A taxpayer made a gift of £170,000 to his son in May 2004. After deducting 2 annual exemptions the taxpayer made a PET of £164,000.

The taxpayer died in January 2011. The death estate was valued at £600,000. In his will the taxpayer left half of the estate to his wife and the remaining half to his son. We will calculate the inheritance tax due on death.

The PET of £164,000 becomes chargeable in January 2011. As this is the only lifetime transfer, a full nil band of £325,000 will be available. The PET is covered by the nil band so no inheritance tax is payable by the donee on the donor's death.

We next calculate IHT on the death estate. The value of the deceased's assets at death was £600,000.

From this we deduct any exempt transfers on death. As half of the estate passes to the wife, the chargeable estate is reduced to £300,000.

Tax on death estate:	£	£
Value at death		600,000
Less: exempt transfers		<u>(300,000)</u>
Chargeable estate		300,000
Nil band at death	325,000	
Less: CTs in 7 years before death	<u>(164,000)</u>	
Nil band remaining		<u>(161,000)</u>
Taxable		<u>139,000</u>
IHT @ 40%		<u>55,600</u>

The nil band on death is reduced by any chargeable transfers in the 7 years prior to death. The PET of £164,000 in May 2004 is a chargeable transfer on death, so this reduces the nil band remaining to £161,000.

This IHT due is payable by the Executors no later than **31 July 2011** - i.e. 6 months from the end of the month of death. This tax will become due on delivery of the form IHT 400 if this is before the normal due date.

11.6 Valuing the death estate

Before we can calculate any inheritance tax due, we must **value the estate** at the date of death. An individual's estate will comprise **all the assets to which he is beneficially entitled at the date of death**. There is no concept of an exempt asset for IHT purposes - all assets must be included on the form IHT 400. From the total value of all assets, we deduct any debts or liabilities owed by the deceased at the date of death.

The value of an asset at the date of death is its "**open market value**". "Open market value" means the **price which the assets might reasonably be expected to fetch if sold on the open market at the point of death**. There are some specific valuation rules for certain assets, and we shall look at these in the next chapter.

[IHTA 1984,
s.160](#)

These open market values must be **included by the Executors on the form IHT 400**. All values are subject to agreement by HMRC. In particular, valuations of assets such as land and buildings, or shares in unlisted companies are regularly scrutinised by HMRC's specialised valuation officers.

11.7 Allowable liabilities

Debts and liabilities are deductible if they are **amounts owed by the deceased at the date of death**. These could be debts for goods and services received, such as credit card bills or store card bills.

[IHTA 1984,
s.5\(3\)](#)

Any outstanding loans or mortgages are deductible. If a loan is secured on a particular asset - for example if a mortgage is secured on a particular property - the liability is specifically deducted from the value of the property in the death estate. For example, the value of a house will be its open market value less any mortgage secured on that property.

One of the most common liabilities owed by the deceased at the time of death is **income tax**. One of the duties of the Executor is to prepare the income tax return to the date of death. If the return shows income tax due to HMRC, this tax is a liability of the estate for inheritance tax purposes. Similarly any capital gains tax due on disposals made by the deceased in the tax year of death, is also an allowable liability. On the other hand, if the deceased is due a repayment either of income tax or capital gains tax, this impending tax repayment is treated as an asset of the estate.

Reasonable **funeral expenses** are deductible. These will include the cost of a tombstone or gravestone and mourning wear for the deceased's family.

[IHTA 1984,
s.172](#)

[SP 7/87](#)

Any costs incurred by the Executors in administering the deceased's estate are **not allowable deductions** in calculating the inheritance tax. Therefore costs such as probate fees etc, are not deductible because **they are not amounts owed by the deceased at the point of death**.

The only exception to this rule is that any **additional expenses of administering or realising property situated abroad** - for example any costs of obtaining foreign probate - are deductible. However, such foreign probate expenses are only allowable up to a **maximum of 5%** of the value of the foreign assets.

[IHTA 1984,
s.173](#)

Illustration 2

Spike died in March 2011. Spike was domiciled in the UK, and his only lifetime transfer had been a CLT of £232,000 in 2006. Spike's death estate was valued at £380,000, being UK assets of £300,000 and a house in India valued at £80,000. Spike left the whole of his estate to his son.

The liabilities at the date of death are as follows:

Liabilities:	£
Income tax and CGT	10,000
Funeral costs	6,000
Probate costs	<u>22,000</u>
	<u>£38,000</u>

The probate expenses included additional costs of £4,500 in relation to the house situated in India.

As Spike is domiciled in the UK, **all of his worldwide assets** are chargeable to inheritance tax. From gross assets of £380,000, we deduct any **allowable liabilities**. The income tax and CGT owed to HMRC at the date of death is an allowable deduction. The funeral expenses of £6,000 are also allowed.

The probate costs incurred by the Executors are not normally allowed, however there is an exception for costs of realising property situated abroad.

The additional probate costs associated with the house in India are £4,500. These costs are deductible, but the amount we deduct **cannot exceed 5% of the value of the foreign property**. The house in India was valued at £80,000, so the allowable deduction is restricted to £4,000.

	£
Assets at death	380,000
Less: liabilities:	
Income tax and CGT	(10,000)
Funeral expenses	(6,000)
Foreign probate costs (max £80,000 x 5%)	<u>(4,000)</u>
Net value of estate	360,000
Nil band	325,000
Less: CTs in prior 7 years	<u>(232,000)</u>
Nil band remaining	<u>(93,000)</u>
Taxable	<u>267,000</u>
IHT @ 40%	<u>£106,800</u>

11.8 The “transferable nil band”

For deaths on or after 9 October 2007 it is possible for the unused nil rate band of one spouse / civil partner to be **transferred to the other spouse** for use on a second death.

[IHTA 1984,
s.8A](#)

In its simplest form this means that:

- 1) if Mr A dies leaving his estate to Mrs A; and
- 2) Mrs A subsequently dies after 9 October 2007; then

the estate of Mrs A can be reduced by **2 nil bands**. If she dies in 2010/11, the nil band available to her estate will be **£325,000 × 2 = £650,000**.

Note it is only necessary for Mrs A to have died after October 2007. **Mr A could have died many years before** - as long as some part of his nil band was unused, the “transferable nil band” rules will apply.

A claim needs to be made by the **executors of the second spouse**. On the death of the first spouse, the unused nil band is recorded but no claim is made.

Note that the uplifted nil band is thereafter used in the calculation of all IHT liabilities arising as a result of death. This will include any tax on PETs & CLTs as well as the death estate.

Illustration 3

Trevor Holland died on 23 September 2002. He left an estate as follows:

	£
Family home and chattels to wife, Enid	400,000
Balance of estate to son Peter	<u>200,000</u>
	<u>600,000</u>

His only lifetime gift had been £30,000 to Peter on his marriage in August 1999.

Enid Holland died on 3 January 2011. She left an estate of £725,000 to her son Peter. She made no lifetime gifts.

Calculate the IHT payable on Enid's estate.

Trevor Holland

PET August 1999:

	£
Gift to Peter	30,000
Less: marriage exemption	(5,000)
Less: AE 1999/00	(3,000)
Less: AE 1998/99	<u>(3,000)</u>
Chargeable on death (covered by nil band)	<u>£19,000</u>

Death estate:

	£	£
Gross estate		600,000
Less: exempt legacy to spouse		<u>(400,000)</u>
Chargeable estate		200,000
Nil band 2002/03	250,000	
Less: PET chargeable on death	<u>(19,000)</u>	
		<u>(231,000)</u>
Taxable estate		<u>NIL</u>
Nil band unused £(231,000 - 200,000)		<u>£31,000</u>
% of nil band unused: $\frac{31,000}{250,000}$		<u>12.4%</u>

Therefore, when Enid Holland dies, we can "uplift" the nil band in her death estate by 12.4%.

Enid Holland

Death estate:

	£
Chargeable estate	725,000
Nil band 2010/11;	
£325,000 x 112.4%	<u>(365,300)</u>
Taxable estate	<u>359,700</u>
IHT @ 40%	<u>£143,880</u>

11.9 More than one spouse/subsequent remarriages

Where a taxpayer has survived more than one spouse / civil partner, additional nil bands **can be claimed from more than one estate.**

Also, if a spouse (Mr X) takes some nil band from a deceased spouse (Mrs X) then subsequently gets remarried (to Miss Y), on Mr X's death any of his unused nil band can be transferred to Miss Y.

However the additional nil band which can be accumulated is **limited to a maximum of the nil band in force at the date of death.** Therefore the maximum nil band any person can have is **2 x the nil band** for the year of death.

Illustration 4

Barbara Knox died on 12 May 2002. She left an estate of £125,000 to her husband John. She had made no lifetime gifts.

John Knox married Frances Gardener in August 2005.

John Knox died on 31 January 2008 leaving an estate as follows:

	£
Family home and chattels to Frances	210,000
Balance of estate to son Peter	<u>400,000</u>
	<u>610,000</u>

He had made no lifetime gifts.

Frances Gardener died on 15 December 2010 leaving an estate of £625,000 to her children. She had made no lifetime gifts.

Calculate the IHT payable on the deaths of John and Frances.

Death of Barbara

No IHT due as estate passing to spouse.

Death of John

Death after October 2007 so "transferable nil band" rules will apply.

John's nil band can be uplifted by 100% as none of his wife's nil band was used when she died.

	£
John's estate	610,000
Less: exempt transfer to Frances	<u>(210,000)</u>
Chargeable estate	400,000
Nil band 2007/08:	
£300,000 × 200%	<u>(600,000)</u>
Taxable estate	<u>NIL</u>
 IHT @ 40%	 <u>NIL</u>
 Nil band unused £(600,000 - 400,000)	 <u>£200,000</u>
 % of nil band unused: $\frac{200,000}{300,000}$	 <u>66.6667%</u>

Death of Frances

On her death in 2010/11, Frances' nil band can be uplifted by 66.67% as some of John's nil band was unused when he died.

	£
Chargeable estate	625,000
Nil band 2010/11:	
£325,000 × 166.6667%	<u>(541,667)</u>
Taxable estate	<u>83,333</u>
 IHT @ 40%	 <u>£33,333</u>

Example 1

Jackie died in December 2010 leaving an estate of £600,000 to be split equally between her son, her daughter and a UK charity.

Her only lifetime gift had been £275,000 to a discretionary trust in July 2004. Jackie paid any lifetime IHT due.

Calculate the tax payable by Jackie's Executors as a result of her death.

Example 2

Dorian died in March 2011. He left his UK assets worth £525,000 to his son and some land in Italy worth £50,000 to his niece. Dorian was domiciled in the UK.

The following expenses were met by his Executors:

	£
Funeral costs	4,000
Memorial headstone	750
Probate fees (UK)	2,500
Additional probate fees (non UK)	2,000

Dorian had made no lifetime gifts.

Calculate the IHT payable by Dorian's Executors.

Example 3

William died on 5 December 2000 leaving an estate of £500,000. He left £100,000 to his son and the residue to his wife, Mary.

His only lifetime gift had been £50,000 to his daughter on 12 July 1998.

Mary died on 13 February 2011 leaving an estate of £600,000 to be split equally between her son and her daughter.

Calculate the tax payable by Mary's executor as a result of her death.

Answer 1

(i) Chargeable lifetime transfer (July 2004)	£
Gift	275,000
Less: AEs x 2	<u>(6,000)</u>
CLT	269,000
Nil band 2004/05 (fully available)	<u>(263,000)</u>
Taxable	<u>6,000</u>
IHT @ $\frac{20}{80}$	1,500
Add: CLT	<u>269,000</u>
Gross chargeable transfer	<u>270,500</u>
Brought forward for cumulation purposes	<u>270,500</u>
(ii) Tax on death estate:	£
Total estate	600,000
Less: exempt gift to charity	<u>(200,000)</u>
Chargeable estate	400,000
Nil band at death	325,000
Less: CTs in 7 years before death	<u>(270,500)</u>
Nil band remaining	<u>(54,500)</u>
Taxable	<u>345,500</u>
IHT @ 40%	<u>138,200</u>

Answer 2

	£
Total assets £(525,000 + 50,000)	575,000
Less allowable deductions:	
Funeral costs and headstone	(4,750)
Probate fees (non UK)	(2,000)
(all allowed as < 5% x £50,000)	_____
Chargeable estate	568,250
Nil band (fully available)	<u>(325,000)</u>
Taxable	<u>243,250</u>
IHT @ 40%	<u>97,300</u>

Answer 3

William - PET July 1998	£	£
Gift		50,000
Less: AE 1998/99		(3,000)
AE 1997/98		<u>(3,000)</u>
Chargeable on death (covered by nil band)		<u>44,000</u>
Death Estate:		
Gross estate		500,000
Less: exempt residue		<u>(400,000)</u>
Chargeable estate		100,000
Nil band 2000/01	234,000	
Less: PET chargeable	<u>(44,000)</u>	
		<u>(190,000)</u>
Taxable estate		<u>NIL</u>
Nil band unused (190,000 - 100,000)		<u>90,000</u>
% of nil band unused $\frac{90000}{234000}$		<u>38.4615%</u>
Mary		
Death estate		
Chargeable estate		600,000
Nil band 2010/11:		
£325,000 x 138.4615%		<u>(450,000)</u>
Taxable estate		<u>150,000</u>
IHT @ 40%		<u>£60,000</u>