

CHAPTER 20

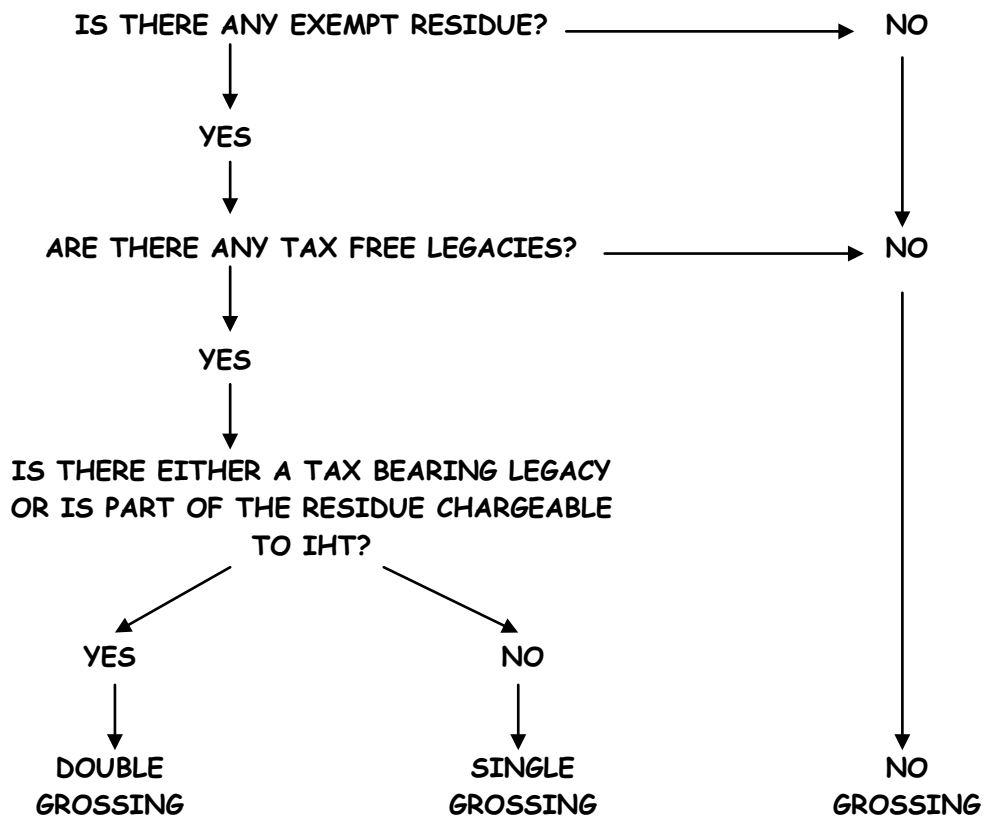
DOUBLE GROSSING

20.1 Identifying grossing-up situations

When working out the IHT on a death estate (and subsequently computing the distribution of the estate between the various beneficiaries), there are three potential routes to follow:

1. No grossing-up (as assumed in the chapters up to chapter 18);
2. "Single grossing" (as outlined in chapter 19); and
3. "Double grossing" (to be outlined here).

To identify whether "to gross or not to gross", follow the flowchart below:



In summary:

SINGLE grossing applies in ONE situation i.e.

- 1) where there are one or more tax free legacies; &
- 2) a wholly exempt residue.

DOUBLE grossing applies in TWO situations i.e.

- 1) where there are one (or more) tax free legacies; &
- 2) a partly exempt / partly taxable residue;

OR

- 1) where there are a mix of tax free & tax bearing legacies; &
- 2) the residue is either wholly or partly exempt.

If none of the above apply, calculate the IHT WITHOUT any grossing up.

Example 1

Consider the following scenarios and decide which (if any) grossing will be required:

SINGLE DOUBLE NONE

1. Villa in Spain to daughter, residue to spouse
2. US share portfolio to nephew, residue divided equally between spouse and daughter
3. House in London to granddaughter, residue divided equally between spouse and son
4. Cottage in France to daughter, house in London to son, residue to spouse
5. UK shares to daughter, residue to spouse
6. UK house to spouse, Villa in Spain to son, residue to daughter

20.2 Double grossing - "the problem"

Illustration 1

Rachel (a widow) died in January 2011. She had made no lifetime gifts. Her estate consisted of the following:

	£
Family home & possessions in London	430,000
Cash & quoted shares	<u>470,000</u>
Total	<u>900,000</u>

She left her house and possessions to her son, Vincent, and the residue to be divided equally between her niece, Tess, and her favourite charity, the NSPCC.

We will calculate the IHT payable on Rachel's death and show how her estate is to be distributed.

The problem we have in trying to calculate the tax is this.

- The gift of the house to Vincent is a tax-free legacy as it is a UK asset. The tax on this legacy will be therefore paid from the residue of the estate.
- To calculate the tax on the tax-free legacy, we need to know the "estate rate" (ie the average rate of tax which applies to the estate).
- To calculate the "estate rate", we need to know the amount of the taxable residue.
- We can't calculate the taxable residue until we know the value of the gross tax-free legacy (which we cannot calculate until we have an estate rate!).
- Therefore we have a circular calculation.

We therefore:

- a) estimate the gross value of the specific legacy and use that estimate to calculate the tax on the residue.
- b) Once we have the estimated tax on the residue, we recalculate the value of the specific gift - this is the "double" in the double grossing procedure.
- c) Once we have a more precise figure for the gross specific legacy, we can work out "real" tax on the residue and divide the estate from there.

Because it is partly based on an estimate, the answer produced by a double grossing situation is not 100% mathematically correct. However it gives us an answer close enough to be accepted by HMRC.

20.3 Double grossing - "the procedure"

The procedure to follow when doing a double-grossing calculation is as follows:

- 1) Gross up the tax free legacies as if they were the only part of the estate which is chargeable to IHT (ie, effectively do a "single grossing" calculation);
- 2) Calculate the chargeable value of the estate and compute notional tax based on this estimated value;
- 3) Use the notional tax to work out an "estate rate";
- 4) Using this estate rate, gross up the tax-free legacy as in Step 1 (this is the "double gross");
- 5) Calculate the chargeable value of the estate and compute IHT based on this value. This gives actual tax payable;
- 6) Recompute the estate rate and use this to show the burden of tax and how the estate is to be distributed.

Illustration 1 (continued)

Rachel (a widow) died in January 2011. She had made no lifetime gifts. Her estate consisted of the following:

	£
Family home & possessions in London	430,000
Cash & quoted shares	<u>470,000</u>
Total	<u>900,000</u>

She left her house and possessions to her son, Vincent, and the residue to be divided equally between her niece, Tess, and her favourite charity, the NSPCC.

We will calculate the IHT payable on Rachel's death and show how her estate is to be distributed.

First look at the will to see whether grossing is required.

Tax free legacy; &) DOUBLE
 A partly exempt / partly taxable residue;) GROSSING

Then follow the 6-step double grossing procedure.

Step 1: Gross up the tax-free legacy as if it was the only part of the estate which is chargeable to IHT (i.e. "single grossing"):

	£
Chargeable estate (assumed)	430,000
Less: nil band	<u>(325,000)</u>
Taxable	<u>105,000</u>
IHT @ 40/60	<u>£70,000</u>
Gross legacy £(430,000 + 70,000)	<u>£500,000</u>

Step 2: Calculate the chargeable value of the estate and compute notional tax based on this estimated value:

	£
Total estate	900,000
Less: gross legacy	<u>(500,000)</u>
Residue	<u>400,000</u>
50% chargeable to tax	<u>£200,000</u>
Taxable estate:	
£(500,000 + 200,000)	700,000
Less: nil band	<u>(325,000)</u>
Taxable	<u>375,000</u>
IHT @ 40% (notional)	<u>£150,000</u>

Step 3: Use the notional tax to work out an "estate rate":

Estate rate:	
$\frac{150,000}{700,000} \times 100$	<u>21.4286%</u>

Step 4: Using this estate rate, gross up the tax-free legacy as in Step 1 ("double gross"):

$£430,000 \times \frac{100}{100 - 21.4286}$	<u>£547,273</u>
---------------------------------------------	-----------------

This is now the gross amount (before tax) of the specific legacy to Vincent.

Step 5: Calculate the chargeable value of the gross estate and compute IHT based on this value. This gives the actual IHT payable.

	£
Total estate	900,000
Less: gross legacy	<u>(547,273)</u>
Residue	<u>352,727</u>
50% chargeable to tax	176,363
Add: gross legacy	<u>547,273</u>
Chargeable estate	723,636
Less: nil band	<u>(325,000)</u>
Taxable	<u>398,636</u>
IHT @ 40% (actual)	<u>£159,454</u>

Step 6: Recompute the estate rate and use this to show the burden of tax and how the estate is to be distributed.

Estate rate:		
	$\frac{159,454}{723,636} \times 100$	<u>22.035%</u>
Tax on tax-free gift to Vincent;		
	$£547,273 \times 22.035\%$	120,592
Tax on chargeable residue;		
	$£176,363 \times 22.035\%$	<u>38,862</u>
Total		<u>£159,454</u>

The tax on the tax-free legacy to Vincent (£120,592) will be suffered equally (£60,296 each) by the residuary legatees (Tess & the charity).

The tax on the chargeable residue and will be suffered by Tess.

	£
Legacy to Vincent	430,000
$\frac{1}{2}$ Residue to NSPCC £(235,000 - 60,296)	174,704
$\frac{1}{2}$ Residue to Tess £(235,000 - 60,296 - 38,862)	135,842
IHT to HMRC	<u>159,454</u>
Total estate	<u>900,000</u>

Illustration 2

Bruce died in December 2010 aged 86. He left a wife (Lilia), 2 children (Austin and Erin) and 2 adult grandchildren (Tom and Camilla). His only lifetime gift was £100,000 to Camilla on the occasion of her marriage in April 2008.

Bruce's estate consisted of the following:

	£
Family home in Oxford ($\frac{1}{2}$ share)	480,000
Flat in London	195,000
Ski chalet in Austria	120,000
UK quoted shares	135,000
UK bank deposits	<u>360,000</u>
Total	<u>1,290,000</u>

The family home was held as joint tenants with Lilia. In his will, Bruce left the ski chalet to Camilla, the flat in London to Tom and the rest of the estate to Lilia, Austin and Erin in equal parts.

We will calculate the IHT payable on Bruce's death and show how his estate is to be distributed.

First look at the will to see whether grossing is required.

Tax free legacy; &)	DOUBLE
Tax bearing legacy; &)	GROSSING
A partly exempt / partly taxable residue;)	APPLIES

Now follow the 6-step double grossing procedure.

Step 1: Gross up the tax-free legacy as if it was the only part of the estate which is chargeable to IHT (ie, "single grossing"):

	£
Chargeable estate (assumed London flat)	195,000
Less: nil band £(325,000 - 91,500) (Note)	<u>(233,500)</u>
Taxable	<u>NIL</u>
 IHT @ 40/60	 <u>NIL</u>
 Gross legacy	 <u>£195,000</u>
 <i>Note:</i>	
Gift to Camilla	100,000
Less: marriage exemption	(2,500)
Less: 2 x AEs	<u>(6,000)</u>
PET (chargeable on death)	<u>91,500</u>

Step 2: Calculate the chargeable value of the estate and compute notional tax based on this estimated value:

	£
Total estate £(1,290,000 - 480,000) (Note)	810,000
Less: gross legacy to Tom	(195,000)
Less: tax bearing legacy to Camilla	<u>(120,000)</u>
Residue	<u>495,000</u>
 2/3 chargeable to tax	 <u>£330,000</u>
 Taxable estate:	
£(330,000 + 195,000 + 120,000)	645,000
Less: nil band	<u>(233,500)</u>
Taxable	<u>411,500</u>
 IHT @ 40% (notional)	 <u>£164,600</u>

Note: share in family home passes to wife by survivorship and is therefore exempt from IHT.

Step 3: Use the notional tax to work out an "estate rate":

Estate rate:	
$\frac{164,600}{645,000} \times 100$	<u>25.5194%</u>

Step 4: Using this estate rate, gross up the tax-free legacy as in Step 1 ("double gross"):

$$£195,000 \times \frac{100}{100 - 25.5194} \quad \text{£261,813}$$

This is now the gross amount (before tax) of the specific legacy to Tom.

Step 5: Calculate the chargeable value of the gross estate and compute IHT based on this value. This gives the actual IHT payable.

	£
Total estate	810,000
Less: gross legacy to Tom	(261,813)
Less: tax bearing legacy to Camilla	<u>(120,000)</u>
Residue	<u>428,187</u>
 2/3 chargeable to tax	 285,458
Add: gross legacy to Tom	261,813
Add: tax bearing legacy to Camilla	<u>120,000</u>
Chargeable estate	667,271
Less: nil band	<u>(233,500)</u>
Taxable	<u>433,771</u>
 IHT @ 40% (actual)	 <u>£173,508</u>

Step 6: Recompute the estate rate and use this to show the burden of tax and how the estate is to be distributed.

Estate rate:	
$\frac{173,508}{667,271} \times 100$	<u>26.0026%</u>
Tax on tax-free gift to Tom:	
£261,813 × 26.0026%	68,078
Tax on tax-bearing gift to Camilla:	
£120,000 × 26.0026%	31,203
Tax on chargeable residue:	
£285,458 × 26.0026%	<u>74,227</u>
Total	<u>£173,508</u>

The tax on the tax-free legacy to Tom (£68,078) will be suffered equally (£22,693 each) by the residuary legatees (Austin, Erin & Lilia).

The tax on the tax-bearing legacy to Camilla will be suffered by Camilla directly.

The tax on the chargeable residue (£74,227) will be suffered equally (£37,113 each) by the residuary legatees (Austin & Erin).

	£
Legacy to Tom	195,000
Legacy to Camilla £(120,000 - 31,203)	88,797
1/3 Residue to Lilia £(165,000 - 22,693)	142,307
1/3 Residue to Austin £(165,000 - 22,693 - 37,113)	105,194
1/3 Residue to Erin £(165,000 - 22,692 - 37,114)	105,194
IHT to HMRC	<u>173,508</u>
	810,000
Add: family home to Lilia as joint tenant	<u>480,000</u>
Total estate	<u>1,290,000</u>

Example 2

John died in March 2011. He never married and had no children. His estate consisted of the following:

	£
Family home & possessions in Liverpool	190,000
Investment property in Manchester	170,000
UK quoted shares	300,000
UK bank deposits & cash ISAs	<u>340,000</u>
Total	<u>1,000,000</u>

His will left £250,000 on trust for his nieces and nephews (specified to be free of tax), his home and possessions to his brother Len, and the residue to be divided equally between his niece, Christina, and a variety of different charities.

John's only lifetime gift had been £50,000 to Christina in March 2008.

Calculate the IHT payable on John's death and show how his estate is to be distributed.

Answer 1

	SINGLE	DOUBLE	NONE
1. Villa in Spain to daughter, residue to spouse			✓
2. US share portfolio to nephew, residue divided equally between spouse and daughter			✓
3. House in London to granddaughter, residue divided equally between spouse and son		✓	
4. Cottage in France to daughter, house in London to son, residue to spouse		✓	
5. UK shares to daughter, residue to spouse	✓		
6. UK house to spouse, Villa in Spain to son, residue to daughter			✓

Answer 2

Step 1: Gross up the tax-free legacies as if they were the only part of the estate chargeable to IHT (i.e. "single grossing"):

	£
Chargeable estate £(250,000 + 190,000)	440,000
Less: nil band £(325,000 - 44,000)	<u>(281,000)</u>
Taxable	<u>159,000</u>
 IHT @ 40/60	 <u>£106,000</u>
 Gross legacies £(440,000 + 106,000)	 <u>£546,000</u>

Step 2: Calculate the chargeable value of the estate and compute notional tax based on this estimated value:

	£
Total estate	1,000,000
Less: gross legacies	<u>(546,000)</u>
Residue	<u>454,000</u>
 50% chargeable to tax	 <u>£227,000</u>
 Taxable estate: £(546,000 + 227,000)	 773,000
Less: nil band	<u>(281,000)</u>
Taxable	<u>492,000</u>
 IHT @ 40% (notional)	 <u>£196,800</u>

Step 3: Use the notional tax to work out an "estate rate":

$$\begin{array}{r} \text{Estate rate:} \\ \frac{196,800}{773,000} \times 100 \end{array} \qquad \underline{25.459\%}$$

Step 4: Using this estate rate, gross up the tax-free legacies as in Step 1 ("double gross"):

$$£440,000 \times \frac{100}{100 - 25.459} \qquad \underline{£590,279}$$

Step 5: Calculate the chargeable value of the gross estate and compute IHT based on this value. This gives the actual IHT payable.

	£
Total estate	1,000,000
Less: gross legacies	<u>(590,279)</u>
Residue	<u>409,721</u>
50% chargeable to tax	204,860
Add: gross legacies	<u>590,279</u>
Chargeable estate	795,139
Less: nil band	<u>(281,000)</u>
Taxable	<u>514,139</u>
IHT @ 40% (actual)	<u>£205,656</u>

Step 6: Recompute the estate rate and use this to show the burden of tax and how the estate is to be distributed.

Estate rate:	
$\frac{205,656}{795,139} \times 100$	<u>25.8642%</u>
Tax on tax-free legacies:	
$£590,279 \times 25.8642\%$	152,671
Tax on chargeable residue:	
$£204,860 \times 25.8642\%$	<u>52,985</u>
Total	<u>£205,656</u>

The tax on the tax-free legacies (£152,671) will be suffered equally (£76,335 each) by the residuary legatees (Christina & the charities).

The tax on the chargeable residue will be suffered by Christina.

	£
Legacy to trust	250,000
Legacy to Len	190,000
$\frac{1}{2}$ Residue to charity £(280,000 - 76,335)	203,665
$\frac{1}{2}$ Residue to Christina £(280,000 - 76,336 - 52,985)	150,679
IHT to HMRC	<u>205,656</u>
Total estate	<u>1,000,000</u>