

CHAPTER 23

PAYMENT OF TAX & THE INSTALMENT OPTION

23.1 Statutory payment rules

[IHTA 1984,
s.226](#)

The rules regarding payment of IHT are contained at S.226 IHTA 1984. Inheritance tax on a chargeable lifetime transfer is payable on the **later** of two dates;

- (i) 6 months from the end of the month in which the transfer took place, or
- (ii) 30 April in the following tax year.

[IHTA 1984,
s.226\(1\)](#)

The IHT return (form IHT 100) is not due until 12 months after the end of the month of the transfer, so the tax will generally be payable before the return is due.

There are different due dates for tax payable as a result of death. Where tax is payable on a PET within 7 years of death, the tax is due no later than **6 months from the end of the month in which the donor died**. The same due date applies for any additional tax due on chargeable lifetime transfers within 7 years of death. Note that the "30 April rule" does not apply here - this rule only applies for lifetime tax.

The due date for tax payable by the Executors on assets within the death estate is very similar, but with one important difference. Tax payable by the Executors is due on the **earlier** of two dates;

- (i) 6 months from the end of the month of death, or
- (ii) on the delivery of the IHT return.

[IHTA 1984,
s.226\(2\)](#)

The Executors are required to have **submitted the IHT return and paid the inheritance tax before an application for probate can be made**. The Executors will include a receipt for the return and the tax when making a probate application.

Therefore, in practice, the IHT will usually be paid well in advance of the normal "6 month" date, as it is important for the Executors to secure probate as soon as they can.

Interest will run on any tax paid late. In the case of tax due on the death estate, interest will run from the **normal due date** - i.e. the "6 months" date - not from the date the return is filed if this is earlier.

23.2 Payment of tax in instalments

[IHTA 1984,
s.227](#)

The relevant statutory rules can be found at S.227 & 228 IHTA 1984. If an individual or an Executor wishes to pay IHT by instalments, a **claim must be**

made - the instalment option is not automatic. If no claim is made, all of the IHT payable is due on the statutory due date.

The ability to pay tax in instalments only applies to transfers of **certain assets**. Such assets are called "qualifying property" (see below).

If an individual or Executor elects to pay the IHT in instalments, the tax is payable in **10 equal annual amounts**. The first payment is due on the normal due date - i.e. 6 months from the end of the month of death, or the normal due date for lifetime tax whichever is appropriate. The instalments will either be "interest free" or "interest bearing", depending on the type of property transferred.

23.3 Who can claim?

[IHTA 1984,
s.227\(1\)](#)

A claim to pay tax by instalments can be made in respect of a chargeable lifetime transfer.

However, a claim can **only be made if the trustees are bearing the IHT**. Therefore, if a donor gifts property to a discretionary trust, and the donor agrees to pay the tax himself, no instalment claim can be made and all of the tax is due and payable on the normal due date.

A claim can also be made in respect of tax payable as a result of death.

A claim can be made either if tax is due from the donee on PETs or chargeable lifetime transfers within 7 years of death, or if IHT is due on the death estate.

As far as PETs or CLTs are concerned, an election to pay the tax in instalments can **only be made if the donee - i.e. the individual or trust - still owns the property at the date of the donor's death**.

[IHTA 1984,
s.227\(1C\)](#)

Therefore if Mr A gives an asset to Miss B, and Mr A dies within 7 years, if Miss B has sold the asset before Mr A's death, no claim can be made and the IHT is fully payable on the normal due date.

The reasoning behind this rule is that presumably Miss B now has cash with which to pay the IHT in full.

There is **one exception** to this rule. If tax is due on **business property** (for example property qualifying for 50% BPR or where BPR does not otherwise wipe out the transfer), if the donee sells the business property and **reinvests the proceeds of sale in acquiring replacement business property**, the right to pay tax in instalments is preserved.

23.4 "Qualifying property"

[IHTA 1984,
s.227\(2\)](#)

A claim to pay tax in instalments can only be made if the assets being transferred satisfy the definition of "qualifying property". Qualifying property is outlined below:

- *Land or buildings.* This includes all forms of land or buildings, wherever situated. The most common form of land contained in a death estate, will be the deceased's private residence. IHT on the residence can be paid in instalments if the Executors so elect.
- *Certain shareholdings.* The shares fall within the definitions laid down in S.228. These will most commonly be shares in unlisted companies. We shall look at S.228 in detail below.
- *A business or partnership share.* Such assets usually qualify 100% BPR - if so, no tax is due so the instalment option is irrelevant. However if BPR is not available (e.g. because the business has not been owned for 2 years), tax will be due and the instalment option can be considered.

The types of assets which qualify for the instalment option, are assets which **cannot be converted easily and quickly into cash**. Therefore assets such as chattels (paintings etc) quoted shares and cash itself, will not be qualifying property and any tax on those assets will be due and payable immediately.

23.5 Shares

[IHTA 1984,
s.228](#)

Shares will only be qualifying property if they fall within S.228. Section 228 is quite a complex section, so we will break it down into its component parts,

- *S.228(1)(a).* Shares will qualify if the transferor had "control" of the company immediately before the transfer. "Control" in this instance means power to exercise **more than 50% of the voting rights**. To determine whether a transferor had "control" of the company, related property will be taken into consideration.

There are **no exceptions** to this rule, so transfers from a **controlling holding of shares will always be "qualifying property"** and tax on those shares can be paid in instalments.

- *S.228(1)(b).* Two conditions must be satisfied. Firstly the shares must **not be quoted** on a recognised Stock Exchange. For these purposes, shares listed on the Alternative Investment Market ("AIM" shares) are treated as unquoted.

Secondly, the **IHT on these shares together with any other IHT payable in instalments must be at least 20% of the total IHT which the Executors are due to pay; i.e.**

$$\frac{\text{IHT potentially payable by instalments}}{\text{Total IHT payable by Executors}} \geq 20\%$$

We will skip S.228(1)(c) for a moment.

- *S.228(1)(d).* 3 conditions must be satisfied:

1. the shares must be **unquoted**; and
2. the "value transferred" by the shares must be at least **£20,000**. This may be the market value of the shares, or it could be a different figure to market value if the "loss to donor" or "related property" rules have been used to measure the transfer; and
3. the shares must form part of **at least a 10% holding** in the company.

If these 3 conditions are satisfied, tax on the shares may be paid in instalments.

If shares fail to satisfy the definition of "qualifying property", no instalment claim can be made. Therefore if the shares do not form part of a controlling holding, or the transfer is of a small amount of unlisted shares which do not satisfy the tests in S.228, all the tax on those shares is payable immediately.

In these circumstances, consideration should be given to making a claim under S.228(1)(c).

The tests we have just examined are "objective" tests. This means that HMRC will simply look at the facts and, assuming the conditions are satisfied, the claim will be allowed.

Under s. 228(1)(c), an Executor can claim that **paying the tax in full on the normal due date would cause him "undue hardship"**. In essence, the Executor is claiming that he **does not have sufficient cash funds** at his disposal to pay the IHT in full.

This is a "subjective" test - i.e. the claim will be allowed at the discretion of HMRC. This claim will be a "last resort" for the Executors. Only if the "objective" conditions in S.228 have not been met will the Executors need to consider a "hardship" claim.

A "hardship" claim **cannot be made for quoted shares** as these can easily be converted into cash by selling them on the open market. The only time that tax on transfers of quoted shares can be paid in instalments is if the transferor has **more than 50% of the shares** in the company.

This is very rare in practice, so in almost all instances, the shares must be unquoted if an instalment option claim can be made.

A transfer of any number of shares in an **unquoted trading company** will qualify for BPR at 100%. Therefore in the majority of cases, where unlisted shares form part of the estate, no IHT will be due so the instalment option becomes irrelevant.

We may need to consider the instalment option if the unlisted shares have **not been owned for 2 years** such that BPR is not available. You are perhaps more likely to come across the instalment option in cases where the deceased had

shares in an **unquoted investment company** or **property dealing company**. Remember, BPR is only available where the company is **trading**. Therefore for shares in non-trading companies, IHT will be due and the instalment option should therefore be considered.

23.6 Other points

Where a claim has been made to pay tax by instalments, HMRC will still accept settlement of the tax at any time. The taxpayer is not bound by the claim and may wish to pay the tax early in order to stop interest from accruing.

[IHTA 1984,
s.227\(4\)](#)

If the qualifying property is **sold by the new owner** whilst tax is still outstanding, the **unpaid balance of tax** (together with any accrued interest) will **become payable in full** at the point of sale.

Illustration 1

A taxpayer died in May 2010 leaving a house to a beneficiary. As land and buildings are always qualifying property, a claim to pay the tax in instalments is made. The first instalment of tax - i.e. 10% - was due on 30 November 2010.

On 1 July 2011, the beneficiary sold the house. At that point, the rest of the tax - i.e. the remaining 90% plus any interest accrued - will be payable.

23.7 Interest on instalments

[IHTA 1984,
s.234](#)

If IHT is paid late, HMRC will levy an interest charge. Interest runs from the day after the normal due date for payment, until the day the tax is paid.

Any IHT repayments will attract repayment interest. This runs from the later of the date of payment of the original tax and the due date to the date of repayment. Repayment interest is tax-free.

The interest position on instalments is slightly more complicated. Where tax is being paid in instalments, those instalments will either be "**interest free**" or "**interest bearing**".

Where instalments are "interest free", this means that **interest will only be charged if the instalments themselves are paid late**. No interest accrues on the unpaid balance of tax.

Where instalments are "interest bearing", **interest is added every year to the unpaid balance of tax**.

Whether instalments are interest free or interest bearing, depends on the type of assets transferred.

Tax payable in instalments in respect of:

- land qualifying for APR; or
- shares in trading companies; or
- a business or partnership share,

are interest free

Tax in respect of **other qualifying property** - for example, land and buildings not qualifying for APR or shares in non-trading companies - will be **interest bearing**.

Perhaps the most common asset on which IHT is paid in instalments, is the deceased's private residence. As this is land which does not qualify for APR, the instalments are interest bearing.

Illustration 2

Elizabeth died on 21 September 2010 having made lifetime transfers of £350,000. Elizabeth's cumulative total has wiped out the nil band, so the whole of her estate will be chargeable to IHT.

The estate consisted of a number of assets as below:

	£
Cash & quoted shares	1,800,000
Shares in Invest-N-Us Ltd (investment company, 5% holding)	75,000
Farmland (note)	160,000
Private residence	250,000

Note: farmland qualifies for 50% APR

We will show when the IHT will be payable, assuming all relevant claims are made.

As there is no nil band available, the whole estate is fully chargeable at 40%.

IHT payable;	£
Cash etc	
£(1,800,000 @ 40%)	720,000
Shares in investment company	
£(75,000 @ 40%)	30,000
Farmland	
(£160,000 × 50%) @ 40%	32,000
Private house	
(£250,000 @ 40%)	<u>100,000</u>
Total IHT payable	<u>882,000</u>

The next step is to consider whether any part of the tax can be paid in instalments.

The tax of £720,000 in respect of the **cash & quoted shares cannot be paid in instalments**. Cash & quoted shares are not qualifying property. This tax is therefore due no later than 31 March 2011.

The tax of £30,000 on the shares in the investment company will only qualify to be paid in instalments if the shares **satisfy the conditions laid down in S.228**. We will examine this later.

The tax on the farmland can be paid in instalments. **Land of any description** will constitute "qualifying property".

The same principle applies to the **private residence**, so this tax of £100,000 can also be paid in instalments if the Executors make a claim.

We now need to consider whether the **shares in the investment company** are "qualifying property". Elizabeth had **5%** of the shares so this, quite clearly, is not a controlling holding.

We therefore need to consider the **"20% test"**. The shares will qualify if the tax on the shares together with any other tax payable in instalments makes up at least 20% of the total tax the Executors are due to pay.

IHT potentially payable in instalments:	£
Cash etc (not qualifying)	nil
Shares in investment company	
£(75,000 @ 40%)	30,000
Farmland (£160,000 x 50%) @ 40%	32,000
Private house (£250,000 @ 40%)	<u>100,000</u>
IHT potentially payable by instalments	<u>162,000</u>

The potential instalment tax as a percentage of the total tax is 18.4%, i.e.

$$\frac{162,000}{882,000} \times 100 = \underline{18.4\%}$$

As this is less than 20%, the test fails.

The final test is whether the value transferred by the shares exceeds **£20,000**, and whether the shares held by Elizabeth made up at least a **10% holding**.

As Elizabeth only had 5% of the shares, this test also fails.

As all of the "objective" tests have failed, all the Executors can do is to claim that paying the tax in full on 31 March 2011 would cause them "undue hardship". It is down to the discretion of HMRC as to whether such a claim would be successful.

Assuming a "hardship" claim is not made, the tax due on 31 March 2011, is as follows:

	£
Tax on cash & quoted shares	720,000

Tax on shares in investment company	30,000
Tax on farmland (1/10)	3,200
Tax on private house (1/10)	<u>10,000</u>
Due 31 March 2011	<u>£763,200</u>

The next lot of tax is due on 31 March 2012.

A further 10% of the tax due on the farmland is payable, being £3,200. Tax on land which qualifies for APR is "interest free". Therefore as long as this instalment is paid on time, **no interest will be added to the tax due.**

A further 10% of the tax on the house is also due on 31 March 2012. Tax on land and buildings which do not qualify for APR, is "interest bearing". This means that as well as paying the second instalment of £10,000, the Executors will also have to pay **interest on the unpaid balance of tax.** The tax outstanding at 31 March 2012 is £90,000. Assuming an interest rate of 4%, the interest charge is £3,600.

	£
Tax on farmland	3,200
Tax on private house	10,000
Interest on unpaid tax £(90,000 x 4%)	<u>3,600</u>
Due 31 March 2012	<u>£16,800</u>

The total payment due on 31 March 2012 is therefore £16,800.

23.8 Penalties for late payment

Non-instalment tax

An initial penalty of 5% of the outstanding tax will be charged in respect of **inheritance tax paid late.**

[FA 2009
Sch 56 Para 3](#)

However, the penalty will only be levied where any tax due is not paid **by the filing date for the return.**

Additional 5% penalties will then be charged where tax is **outstanding;**

- **more than 5 months** after the first penalty is charged; **and**
- **more than 11 months** after the first penalty is charged.

These penalties apply in **addition to interest charges** for tax paid late.

Illustration 3

Orson made a transfer to a discretionary trust in July 2010, resulting in a tax liability of £10,000. Orson paid the tax due on 28 January 2012.

The due date for the tax is 30 April 2011. Therefore interest will run from this date.

The due date for the IHT return is 31 July 2011. The tax is paid on 28 January 2012, so the tax is outstanding for 6 months from the due date for the IHT return. Late payment penalties will therefore be charged.

The initial penalty is $£10,000 \times 5\% = £500$.

The tax was still outstanding 5 months after the first penalty was charged (ie, by 31 December 2011). Therefore an additional 5% penalty will be charged at this point (being another £500).

The total late payment penalty is therefore £1,000.

Instalment tax

IHT liabilities in respect of certain assets can be paid by instalments.

If the first instalment is paid late, interest is charged.

If the first instalment is paid after the due date for filing the IHT return, late payment penalties will also be charged.

The initial penalty will be 5% of the unpaid instalment.

If the **second and subsequent instalments are more than 30 days late**, a 5% penalty can be imposed.

Additional 5% penalties will be charged if the tax is not paid within 5 months or 11 months of the first penalty being levied.

Illustration 4

Zelma transferred a property to a discretionary trust on 3 May 2010. The Trustees agreed to pay the £40,000 of IHT due. The Trustees also elected under S.227 to pay this tax by instalments.

The Trustees made the following tax payments:

1 st instalment	£4,000	15 May 2011
2 nd instalment	£4,000	1 August 2012

We will consider whether late payment penalties will be charged.

1st instalment:

The first instalment of £4,000 is due on 30 April 2011.

The Trustees paid the tax on 15 May 2011. This is late, so interest will be charged.

A late payment penalty will not be charged as the instalment is paid before the filing date for the return (which is 31 May 2011).

2nd instalment:

The second instalment of £4,000 is due on 30 April 2012.

The Trustees paid the tax on 1 August 2012. This is late, so interest will be charged.

As the tax was not paid within 30 days of the due date (ie, by 30 May 2012), a 5% late payment penalty will be charged (£4,000 @ 5% = £200).

No further 5% penalty is levied as the tax was paid within 5 months of 30 May 2012.

Example 1

Donald gives a holiday cottage worth £500,000 to a discretionary trust on 25 September 2010. The trustees agree to pay the IHT due.

Which of the following statements is true?

- a) The tax is fully due and payable by 31 March 2011
- b) The tax is fully due and payable by 30 April 2011
- c) The trustees can elect to pay the tax in instalments starting on 31 March 2011
- d) The trustees can elect to pay the tax in instalments starting on 30 April 2011.

Example 2

Alfred died on 12 January 2008 leaving an estate as follows:

	£
Quoted shares	100,000
Paintings	200,000
Main residence	300,000

IHT on the estate was £150,000. All relevant claims were made.

Assuming an interest rate of 5%, calculate the IHT due on 31 July 2010.

Answer 1

Answer D is correct.

The normal due date is later of:

- (i) 6 months from end of month of gift, i.e. 31 March 2011; or
- (ii) 30 April in next tax year, i.e. 30 April 2011.

Normal due date is 30 April 2011.

Instalment option available because **trustees pay** and the cottage is "**qualifying property**".

Answer 2

Tax on house payable by instalments

$$\text{Tax on house} = \text{£}150,000 \times \frac{300,000}{600,000} = \underline{\text{£}75,000}$$

Normal due date = 31.7.08

∴ 31.7.10 = 3rd instalment

	£
Tax due = $\text{£}75,000 \times \frac{1}{10}$	7,500
Add interest on unpaid tax	
$\text{£}(75,000 - 7,500 - 7,500) \times 5\%$	<u>3,000</u>
Due 31.7.10	<u>£10,500</u>