

CHAPTER 22

ESTATES IN ADMINISTRATION

22.1 Legal background

Executors are appointed by the deceased in the will. At the date of death, the assets of the deceased pass to the Executors. The Executors take legal ownership of the assets at the date of death, although this will be formally recognised once the Executors have obtained grant of probate.

The Executors have a number of duties and responsibilities under English law:

- (i) The Executors must **determine the assets and liabilities** of the deceased at the date of death.
- (ii) They must make **application for probate**. Application is made to the Probate Registry and gives formal recognition to the vesting of the assets in the Executors.
- (iii) The Executors must **collect the assets and ensure that all liabilities are settled**.
- (iv) The Executors must deal with HMRC, and **settle all tax liabilities** arising both as a result of death and in respect of income and gains made by the Executors during the administration period.
- (v) The Executors must **distribute the estate** in accordance with the will of the deceased. Distributions are made to nominated beneficiaries of the estate.

22.2 Tax liabilities of the Executors

There are a number of potential tax liabilities arising to the Executors as a result of death.

One of the first tasks will be to complete the **deceased's income tax return** covering the period from 6 April to the date of death. If any returns are outstanding for any previous tax years, it is the Executors' responsibility to arrange for these returns to be submitted and for the tax affairs of the deceased to be brought up to date.

The Executors will settle any income tax owed by the deceased for the tax year of death, and for any previous years if appropriate. Any tax owed to HMRC at the point of death, is treated as a **liability of the estate** for IHT purposes.

Therefore, the income tax returns must be finalised before the IHT liability can be correctly calculated.

The return will also include any **capital gains in the year of death**. Again, any CGT due is a **liability of the estate for IHT**. If any income tax or CGT is **repayable** to the Executors, the repayment is an **asset of the estate** and will be included within the IHT computation.

It is the Executors' responsibility to arrange for **payment of any IHT** arising on the death estate. The Executor will submit a form IHT 400, and the form will include a calculation of the IHT due.

Remember that the Executor is only responsible for settling any IHT **due on the free estate**. Tax on lifetime gifts within 7 years of death will be paid by the donees, although details of the transfers will be included in the IHT return.

Similarly, any assets held on qualifying IIP trust will also be included in the IHT return, although the tax will be settled by the trustees of the interest in possession trust.

The IHT return, and the tax on the death estate, must be discharged before application for probate can be made.

Finally, the Executors will submit **tax returns** giving details of any income and **gains accruing to them during the period of administration**. Certain assets within the death estate will produce income. As this income legally belongs to the Executors until such time as the assets are distributed, the Executors will pay any income tax on this income.

Similarly if the Executors sell any assets and make a profit, the Executors will have a CGT liability.

22.3 The year of death

One of the first tasks of the Executor will be to prepare the income tax return for the year of death.

Income arising between 6 April and the date of death must be included on the deceased's tax return. If the deceased had trading profits or, rents from a property business, the income should be calculated on an **accruals basis**. Death will be a cessation of trade for trading income purposes, so time apportionment of trading profits will be required.

Income such as employment income, interest or dividends will be taxable on a **receipts basis**. Therefore any bank interest or employment income earned before death, but actually received after death, will be reflected on the Executors' return and will not be disclosed on the deceased's personal return. It is therefore important that the correct income is allocated to the correct period.

Full personal allowances are available in the year of death. Therefore if a taxpayer dies in the early part of the year, it is possible that taxable income may be covered by allowances and a tax repayment could result.

The return must also include capital gains for the period before death.

A **full annual exemption** is available for the year of death. If the deceased made **capital losses** in the tax year of death, these losses may be **carried back for up to three years**. Such a claim may generate a CGT repayment which (in turn) would be included as an asset of the estate for IHT purposes.

The Executors' administration period will start at the date of death. Any income and gains arising after the date of death will be included on the Executors' income tax return. This will include interest and dividends earned before death, but paid to the Executors after death.

22.4 Income tax during the administration period

Tax returns must be submitted by the Executors for the period from the date of **death to the end of the administration period**.

This period may straddle more than one tax year, in which case returns are required for **each separate tax year**.

The administration period comes to an end once the residue of the estate has been ascertained. This is usually before the date on which the assets are finally distributed to the beneficiaries. The date the administration period is completed will usually be the date to which final estate accounts are made up.

The Executors are bound by **normal self-assessment rules** - i.e., return are filed by 31 January or 31 October depending on whether the Executors choose to file electronically or non-electronically. The interest and penalty provisions are the **same** as for individuals.

The way we tax Executors on their estate income, is a relatively straightforward exercise. Executors are **taxed in the same way as an interest in possession trust**.

Non-savings income - for example trading income, rental profits or employment income - is taxed at the basic rate of 20%. Interest is taxed at the basic rate of 20%. Dividends are charged at the dividend rate of 10%. **No relief is available for expenses** incurred by the Executors in managing the estate.

The Executors **cannot claim personal allowances** to set against their estate income. The effect of these rules is that the Executors will only pay tax on their untaxed income. If interest is received net of tax, the tax credit satisfies the liability and no additional tax is due. There is no extra tax payable on dividend income.

If the Executors have taken out a loan to pay the inheritance tax, any interest on the loan is a deductible payment. This may be the case if the Executors need to pay the IHT quickly in order to secure probate, but there is little cash within the estate.

Relief is only available for interest paid within 12 months of the loan being taken out. Interest paid after this date is not deductible for tax purposes.

The deductible payment is deducted from non-savings income in priority to interest or dividends.

If the interest paid exceeds the gross income for the year, the excess charges may be carried back and offset against estate income of the preceding tax year. Thereafter any excess charges may be carried forward.

Illustration 1

Bert died on 25 June 2010. Bert owned an investment property, producing rental profits of £12,000 per annum. Bert had a job, and his salary of £4,000 for June 2010 was paid to his Executors on 30 June. PAYE of £1,000 was withheld.

On 1 October 2010, the Executors took out a loan of £50,000 to meet the IHT due. Interest is charged at a fixed rate of 10% per annum. On 31 December 2010, the Executors received annual interest of £2,000 on a National Savings account. On 1 February 2011, the Executors received a final dividend of £900 in respect of the company year ended 31 December 2010.

We need to calculate the income tax liability of the Executors on their estate income in 2010/11.

	<i>Non savings</i>	<i>Interest</i>	<i>Dividends</i>
	£	£	£
Employment income	4,000		
Rental profits (£12,000 × 9/12)	9,000		
Interest (gross)		2,000	
Dividends (× 100/90)			1,000
Less deductible payment (£50,000 × 10% × 6/12)	<u>(2,500)</u>		
Taxable	<u>10,500</u>	<u>2,000</u>	<u>1,000</u>
Taxed at	20%	20%	10%
	£2,100	£400	£100
Less: PAYE/tax credits	<u>(1,000)</u>		<u>(100)</u>
Tax due	<u>£1,100</u>	<u>£400</u>	<u>Nil</u>
	<u>£1,500</u>		

The tax of £1,500 is payable on 31 January 2012 under normal self-assessment rules.

22.5 Capital gains tax on UK estates

Executors are deemed to acquire the assets of the deceased at the date of death, at a base cost equal to their market value at death (the probate value). If the Executors have made **post-mortem relief claims** under which the value of certain assets (most commonly quoted shares and land) has been adjusted for IHT purposes, the **new "adjusted" value will become the CGT base cost**.

The Executors are liable to CGT on any gains made by them on disposals during the administration period. Normal CGT rules apply to calculate the gain.

The Executors receive an **annual exemption for the year of death and the next 2 tax years only**. Therefore if the administration period continues beyond three tax years, annual exemptions will not be available in the later years. The exemption is the same as that for individuals (£10,100 in 2010/11).

Capital losses are set against gains in the same year, and any **excess losses are carried forward**. Capital losses cannot be carried back or used against any disposals made by the deceased prior to death. There is no provision whereby unused capital losses can be transferred to beneficiaries. Therefore any unused losses at the end of the administration period will be wasted.

The **rate of CGT to be applied to estate gains is:**

- 18% for disposals on or before 22 June 2010; and
- 28% for disposals after 22 June 2010.

These rates are the same as those for UK trusts.

Finally, a **distribution of an asset** by the Executors to a beneficiary in settlement of a legacy under the will is **not treated as a disposal** for CGT purposes. If a beneficiary is left an asset under the terms of a will, he or she is deemed to have acquired the asset at the date of death for its probate value. Therefore the value of the asset at the time it is actually distributed, is irrelevant.

22.6 CGT on estates - other rules

Principal private residence (PPR) relief can be available if the Executors sell the main residence of the deceased. PPR relief is available if the house was also the main residence of the beneficiary who is entitled to 75% or more of the net proceeds of sale under the terms of the Will.

[TCGA 1992,
s.225A](#)

In order to obtain legal title to the assets of the deceased, the Executors will incur certain costs, in particular costs of obtaining probate. Under general CGT principles, the cost of establishing one's title to an asset is an allowable deduction for CGT purposes. Therefore, in calculating the Executors' gain on the sale of an asset, a deduction can be made for any costs of obtaining probate.

HMRC gives the Executors two choices. Relief can either be claimed for the **actual costs of obtaining probate**, or alternatively a deduction can be taken for a **fixed percentage using scale rates** laid down in SP 2/04 (reproduced below).

SP 2/04

<u>Gross value of estate</u>	<u>Allowable expenditure</u>
A Up to £50,000	1.8% of the probate value of the assets sold by the Executors.
B Between £50,001 and £90,000	A fixed amount of £900 to be divided between all the assets in the Estate in proportion to their probate values.
C Between £90,001 and £400,000	1% of the probate value of the assets sold.
D Between £400,001 and £500,000	A fixed amount of £4,000 to be divided as at B above.
E Between £500,001 and £1,000,000	0.8% of probate value of the assets sold.
F Between £1,000,000 and £5,000,000	A fixed amount of £8,000 to be divided as at B above.
G Over £5,000,000	0.16% of probate value of the assets sold, subject to a maximum of £10,000.

Illustration 2

Gerald died on 10 April 2010. He left his entire estate to his wife. At the date of his death, Gerald had three assets as below:

Death estate:	MV £	Probate costs £
Main residence	300,000	400
Quoted shares	250,000	500
Investment property	<u>100,000</u>	<u>400</u>
Gross estate	<u>650,000</u>	<u>1,300</u>

The Executors sold the private house on 31 August 2010 for £320,000, thereby making a gain of £20,000. As the house is the main residence of the beneficiary, and the beneficiary is entitled to at least 75% of the sale proceeds, the gain can be covered by PPR relief.

The Executors sold the quoted shares in September 2010 for £275,000. The gain will be chargeable to CGT.

In October 2010, the Executors transferred the investment property to the wife in satisfaction of her legacy. The distribution of an asset to a beneficiary under the terms of the will is not a disposal for CGT purposes. Gerald's wife is deemed to have acquired the property at the date of death, with a base cost of £100,000.

The CGT payable by the Executors on the sale of the quoted shares is as below:

	£
Sale proceeds	275,000
Less: probate value	(250,000)
Less: cost of obtaining title to assets (W)	(2,000)
Less: annual exemption	<u>(10,100)</u>
Taxable gains	<u>12,900</u>
 CGT @ 28%	 <u>£3,612</u>

(W) Working:

Cost of obtaining title is higher of:

(i)	Actual cost	£500
(ii)	£250,000 × 0.8%	£2,000

Note: 0.8% applies as gross estate between £500,001 and £1,000,000
(see SP 2/04)

22.7 Miscellaneous points on tax returns

There are one or two practical rules regarding tax returns for Executors.

The tax affairs of the Executors are normally dealt with by the tax office which dealt with the deceased. However, if the value of the estate exceeds £400,000, or a trust was established under the will, the Executors' affairs will be dealt with by a **trust district**.

Executors can ask HMRC to issue a tax return before the end of the relevant tax year. This may be convenient if the administration period has been completed, and the Executors do not want to wait until the following April to complete the estate return.

The Executors can also ask HMRC to give written confirmation that they do not intend to open an Enquiry into the tax return. This will enable them to complete the administration of the estate and apply for a Certificate of Discharge, safe in the knowledge that HMRC will not seek to alter the figures submitted.

Whilst HMRC has said that such confirmation will normally signify the end of its interest in the tax affairs of the estate, they have commented that they would not be precluded from raising a discovery assessment in exceptional circumstances, if the return has been found to be incorrect or incomplete.

22.8 Intestacy

Where a person **dies without having made a valid will**, they are said to have died "intestate". In this case, personal representatives of the deceased are appointed by the Courts to deal with the administration of the estate. Such representatives are called **Administrators**.

The Administrators will obtain Letters of Administration, and will distribute the estate according to the rules laid out in the Administration of Estates Act (AEA) 1925.

The way an estate is distributed under the Intestacy rules depends on whether the deceased left a surviving spouse.

- (i) If the deceased left a surviving **spouse but no "issue"** (i.e., children or grandchildren), and **no relatives** (siblings or parents), the whole of the estate passes **to the spouse**.
- (ii) If the deceased dies leaving a **surviving spouse and issue** the surviving spouse receives the personal chattels, a fixed sum of £250,000 and a life interest in 50% of the residue. The issue receive 50% of the residue absolutely, and an interest in the remainder - i.e. a right to capital once the surviving spouse dies.
- (iii) If the deceased leaves a **surviving spouse, no issue but close relatives** (for example, brothers or sisters), the spouse receives a fixed sum of £450,000, plus the chattels and an interest in half of the residue.
- (iv) If there is **no surviving spouse**, the estate passes to the nearest group of relatives in the order as per the screen.
- (v) If there is no spouse and no relatives, the estate passes to the Crown.

The intestacy sections from the Administration of Estates Act (AEA) 1925 are reproduced in Volume 3 of your Tolley Yellow Tax Handbooks.

Example 1

Brian died in May 2009 leaving the following estate:

	MV £	Probate costs £
ABC plc shares	90,000	700
DEF Trading Ltd shares	85,000	925
Gilts and bank deposits	<u>50,000</u>	<u>175</u>
	<u>£225,000</u>	<u>£1,800</u>

On 21 July 2010 the Executors sold the ABC shares for £80,000 and the DEF shares for £150,000.

Calculate the CGT payable by the Executors.

Answer 1

	ABC plc	DEF Ltd
	£	£
Proceeds	80,000	150,000
Less: probate value	(90,000)	(85,000)
Less: costs of obtaining probate (note)	<u>(900)</u>	<u>(925)</u>
Gain/loss	<u>(10,900)</u>	<u>64,075</u>
		£
Net gains £(64,075 - 10,900)		53,175
Less: annual exemption		<u>(10,100)</u>
Taxable gains		<u>43,075</u>
CGT @ 28%		<u>£12,061</u>

Note: Higher of 1% of probate value and actual cost.