

Incidence of inheritance tax in estates

Good drafting of wills aims to avoid uncertainty, including uncertainty about who should bear the inheritance tax. Being calculated at 40%, this can make a big difference to the amount of a gift.

Structure of a will

Gifts by will take a variety of forms, the most common being:

Legacies

Fixed sums of money, e.g. "£5,000 to my son John"

Specific bequests

Gifts of chattels, e.g. "My card table to my daughter Jean"

Property gifts

Gifts or trusts of property, e.g. "Blackacre for my wife for life"

Residue

The whole of the rest of the estate, after payment of legacies etc. Residue in particular is often split between several people, equally or in different percentages.

Inheritance tax

In general, the whole of a deceased person's estate is taxable. The first quarter million pounds or so in value is called the Nil Rate Band, and is effectively tax free. The rest (except for certain business or agricultural property) is taxed at 40%. However, anything passing to the spouse or civil partner of the deceased is exempt (as long as the spouse or civil partner is domiciled in England and Wales). So is any gift to charity.

Tax on legacies and specific bequests

These are usually expressed in wills as "free of inheritance tax". This does not mean that no inheritance tax is due on the amount of the legacy or bequest; it simply means that the tax is to be paid out of Residue.

Tax on Residue

Where the whole of Residue is given to a tax-exempt spouse or civil partner, no tax is payable unless legacies, bequests (and possibly lifetime gifts brought back into account) exceed the Nil Rate Band. Then, the recipients of those lifetime gifts, and possibly the recipients of the legacies or bequests, will usually bear the tax, rather than the widow/widower or partner. Where legacies to charities have been mixed with legacies to people, the value of the charitable gifts will have to be "grossed up" and the computations can be complex.

Where Residue all goes to people who are not exempt, tax will be payable on the whole value of the estate, after allowing for exemption for any charitable legacies.

But where Residue is split between the widow/widower or partner (or charities) and other people, difficulties arise. There are two approaches:

- 1 *Net division.* The Residue is divided into such proportions that, after payment of inheritance tax attributable to the non-exempt beneficiaries' shares, the non-exempt and exempt beneficiaries receive the net proportions set out in the will.
- 2 *Gross division.* The Residue is first divided into the proportions set out in the will, after which the inheritance tax attributable to the non-exempt beneficiaries' shares is calculated and deducted from their gross inheritance. The exempt beneficiaries receive their gross proportion without any deduction.

Net division usually gives rise to a greater tax amount overall.

For the beneficiaries of Residue, the different approaches can give rise to significant differences in net receipts. So wills should be clear about the method to be used, net or gross.

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