

FOR LEGAL

Learning without limits

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Inheritance tax and the charity exemption



Outline

- › Introduction to inheritance tax
- › The charity exemption
- › The reduced rate of inheritance tax: the “10% rule”
- › Worked examples
- › Establishing gifts as *Re Benham v Re Ratcliffe* in practice
- › Calculating residuary gifts under *Re Ratcliffe* in practice

Introduction to inheritance tax


- › The basis of the charge: section 1, Inheritance Tax Act 1984
- › Death: section 4
- › Charged at 40% (section 7 and Schedule 1)
- › Assumptions
 - › Domiciled in UK for inheritance tax purposes
 - › No settlement interests
 - › No gifts with reservation of benefit
 - › No transfers of value during lifetime
 - › The nil rate band
- › References are to the Inheritance Tax Act 1984 unless stated otherwise
- › Law correct as at 6 April 2022
- › Spouse refers to both spouses and civil partners

The charity exemption

- › Section 23
- › Qualifying charities

The reduced rate of inheritance tax: the “10% rule”

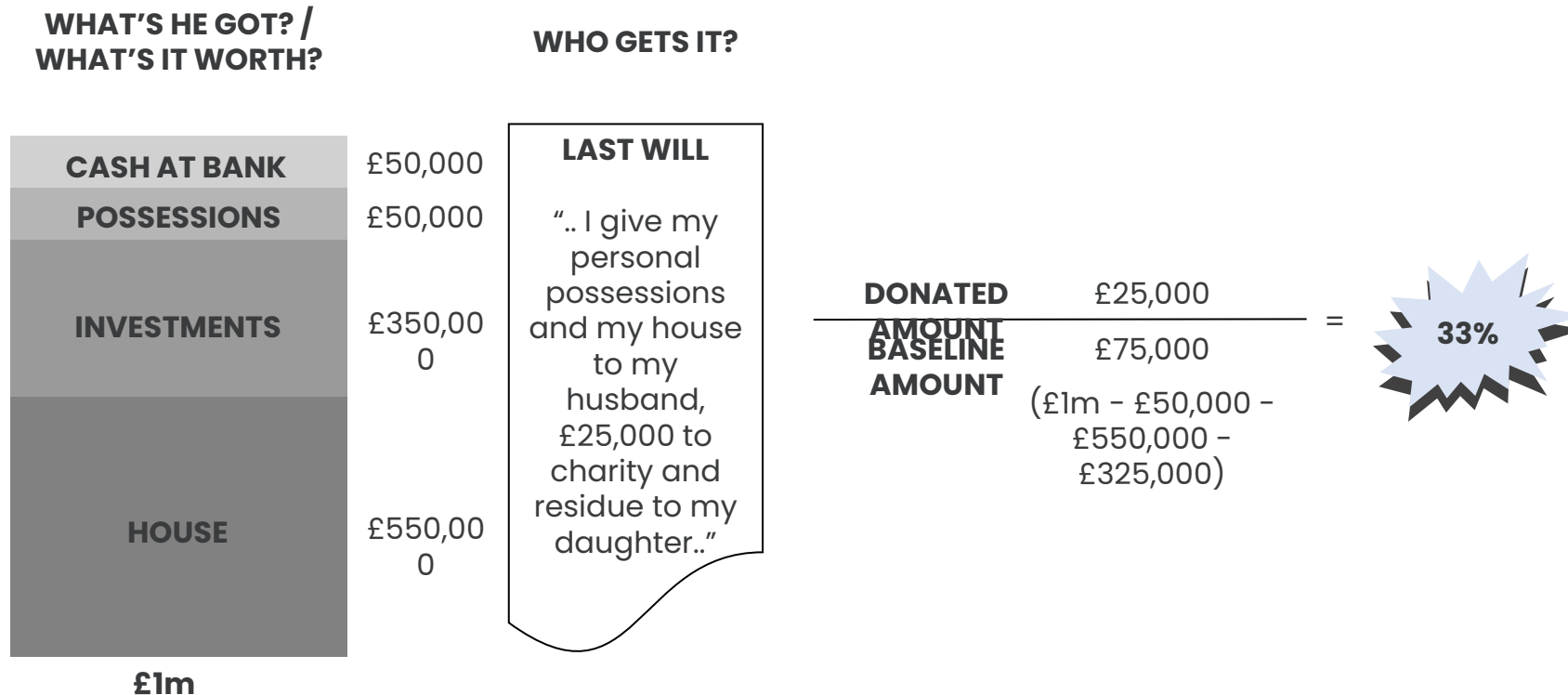
- › Schedule 1A
- › Applies for deaths on or after 6 April 2012
- › Testators who leave 10% or more of their net estates to charity qualify for the reduced rate of inheritance tax of 36% on their chargeable estate, rather than the standard 40%

$$\text{If } \frac{\text{DONATED AMOUNT}}{\text{BASELINE AMOUNT}} > 10\% \rightarrow \text{IHT @ 36\%}$$


- › **DONATED AMOUNT** is the £ value of assets exempt from IHT under the charity exemption
- › **BASELINE AMOUNT** is the £ value of assets being transferred under the terms of the Will after taking account of (1) any exemptions/reliefs e.g. spouse exemption (but not, in this example, the charity exemption); and (2) the nil rate band allowance used (ignoring RNRB)
- › This assumes the estate consists of the “general component” only – the ‘free estate’

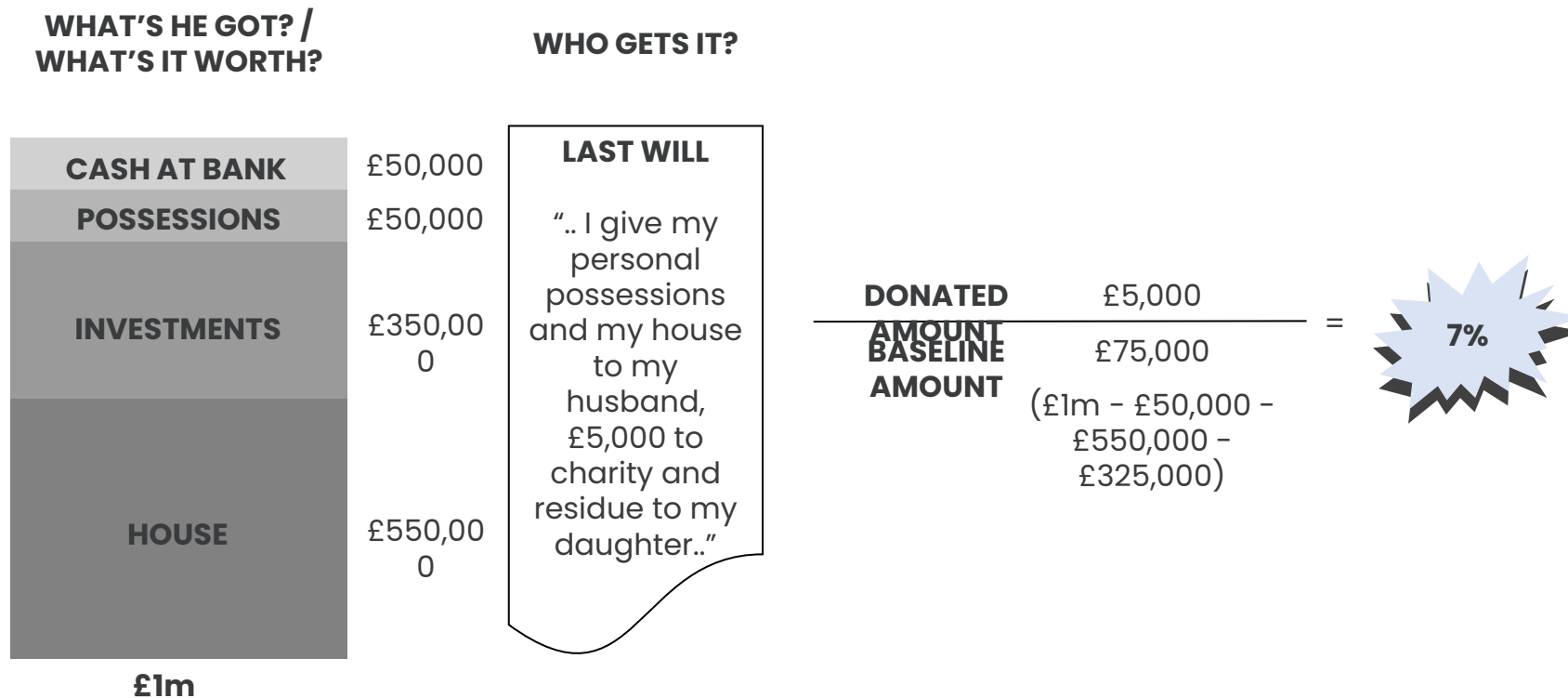
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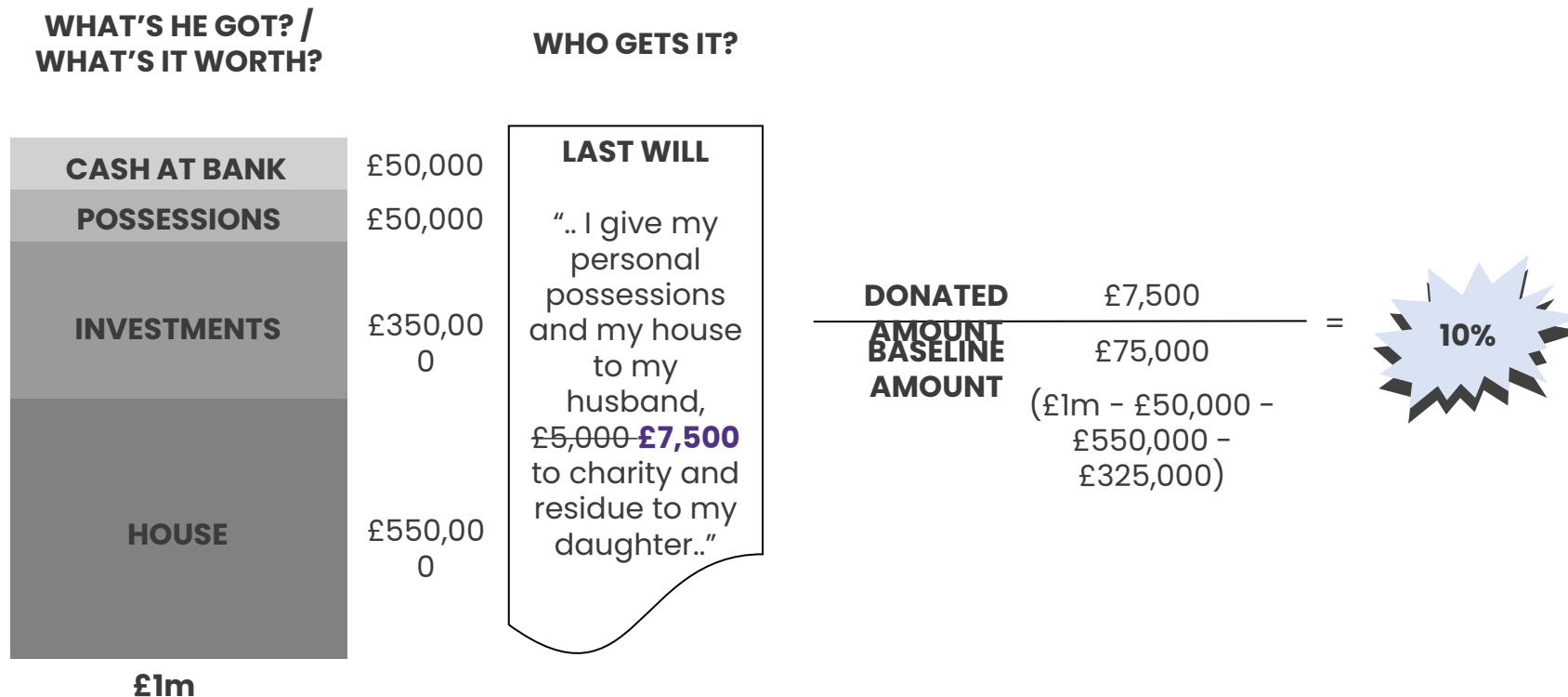
The reduced rate of inheritance tax: the “10% rule”

	£
Estate (after debts)	1,000,000
Less exemptions	
Charity exemption	(5,000)
Spouse exemption	(600,000)
Chargeable residuary estate	395,000
Less available nil rate band	(325,000)
Taxable estate	70,000
IHT at 40%	28,000

Daughter receives residue of £395,000, less £28,000 IHT = £367,000

The reduced rate of inheritance tax: the “10% rule”

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The reduced rate of inheritance tax: the “10% rule”

	£
Estate (after debts)	1,000,000
Less exemptions	
Charity exemption	(7,500)
Spouse exemption	(600,000)
Chargeable residuary estate	392,500
Less available nil rate band	(325,000)
Taxable estate	67,500
IHT at 36%	24,300

Daughter receives residue of £392,500, less £24,300 IHT = £368,200.

A variation under section 142 increases the amount passing to charity by £2,500 more and the daughter also receives a further £1,200 – equating to the tax saving of £3,700 from the last example.

The reduced rate of inheritance tax: the “10% rule”

- › Claims are made on IHT430 within two years of death
- › Components (paragraph 3, Schedule 1A)
 - › Survivorship component
 - › Settled property component
 - › General component
- › Election to merge components – treated as a single component and lower rate of IHT applies to all of it (paragraph 7, Schedule 1A)
 - › Free estate of £8,000,000 left to charity
 - › Settled property of £1,000,000 – a qualifying interest in possession with remainder to children absolutely
- › Claims must be made by the “appropriate persons” (paragraphs 7(7) & 8(2), Schedule 1A)
- › Watch out: apportionment of the nil rate band across components can cause the calculation to be tricky in practice!

Re Benham v Re Ratcliffe

- › Where IHT payable on UK free estate, it is treated as a testamentary expense (section 211(1)).
- › Where a specific gift or residuary gift is made to an exempt beneficiary (eg a charity), none of the IHT shall be deducted from that exempt gift (section 41). That cannot be overridden by the terms of the will.
- › Issues where there is a residuary gift mixing exempt and non-exempt beneficiaries
- › Option 1: division after IHT calculated – as in Re Benham's Will Trusts (1995) STC 210
 - › "to pay the same to those beneficiaries as are living at my death and who are listed in List A and List B hereunder written in such proportions as will bring about the result that the aforesaid beneficiaries named in List A shall receive 3.2 times as much as the aforesaid beneficiaries named in List B."
- › Option 2: division before IHT calculated – as in Re Ratcliffe Holmes v McMullan (1999) STC 262
 - › "after payment thereof of my debts and funeral and testamentary expenses to stand possessed of the residue as to one-half part thereof for John Hugh McMullan and Edward Brownlow McMullan (the sons of my cousin Helen McMullan) in equal shares absolutely and as to the remainder of my estate upon trust for the following [four] charities in equal shares."
- › HMRC IHT manual IHTM26171 & IHTM26172

Re Benham v Re Ratcliffe

› How might you consider this in practice?

Following an unfortunate run in with an alien, Frank-N-Furter died on 1st February 2019. He left a Will with the following provision:

I leave my residuary estate to my trustee to divide into twenty (20) equal shares and hold each share upon trust as follows:

As to two (2) shares to each of Rocky, Riff Raff and Magenta absolutely

As to one (1) share to each of Brad, Janet, Dr Scott and Columbia absolutely

As to ten (10) shares to such of The Castle Restoration Society (Registered Charity Number 9837502), The Rehabilitation of Persons Abducted by Aliens Fund (Registered Charity Number 8904678) and The Charity for Retired Criminologists (Registered Charity Number 6783564) and if more than one in equal shares absolutely

Re Benham v Re Ratcliffe

- › If this is *Re Ratcliffe*, what is the tax due, assuming the net residuary estate is £826,115?

Re Benham v Re Ratcliffe

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	£
Net estate from capital account	826,115.00
10 shares to non-exempt beneficiaries	413,057.50
10 shares to exempt beneficiaries	413,057.50
The non-exempt shares are subject to IHT:	
Gross share	413,057.50
LESS nil rate band	<u>(325,000.00)</u>
Taxable amount	88,057.50
 IHT @ 36%	 31,700.70

Re Benham v Re Ratcliffe

› If this is *Re Ratcliffe*, how should the distribution have been calculated?

Re Benham v Re Ratcliffe

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Residuary estate available for distribution:

Distribution account	719,657.30
PLUS IHT paid	<u>31,700.70</u>
	751,358.00
10 shares to exempt beneficiaries	375,679.00
= <u>125,226.33 per charity (x3)</u>	
10 shares to non-exempt beneficiaries	375,679.00
LESS IHT	<u>(31,700.70)</u>
	343,978.30
= <u>34,397.83 per share</u>	

Conclusion

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