Inheritance tax and probate

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Inheritance tax (IHT) is levied on the value of a person's estate at the time of their death. The tax is charged at 40% above the tax-free threshold, set at £325,000 for 2010-11; it is estimated the tax will raise £2.3 billion in this year.[1]

When someone dies, the personal representative is the person who administers the deceased person's estate. Their responsibilities include: finding and valuing the deceased's assets, providing information on the value of the estate to HM Revenue & Customs (HMRC), paying any inheritance tax which may be due, as well as applying for a grant of representation. Guidance on these procedures is set out in HMRC's online guidance on the tax,[2] as well as on the DirectGov site.[3]

In March 2003 the Government introduced a new Direct Payment scheme, to deal with a problem created by the interaction between the conditions placed on an estate before a grant of probate is issued, and the requirements to pay inheritance tax on that estate. In brief, personal representatives have to pay any tax due on most types of asset before a grant of probate can be issued. However, they will be unable to have access to the assets of the estate to meet this tax bill *until* they have a grant of probate. This note describes the introduction of the new scheme, before looking at certain new administrative procedures for completing an IHT return which were introduced in November 2004.

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1 *Budget 2010* HC 451 March 2010 p193
2 See the section, "What are the responsibilities of the personal representatives?"
At: http://www.hmrc.gov.uk/cto/customerguide/page4.htm
3 See the section, "Applying for probate"
At: http://www.direct.gov.uk/en/Governmentcitizensandrights/Death/Preparation/DG_10029716

1 The Direct Payment scheme

Someone's 'personal representatives' are the individuals charged with dealing with that person's estate on their death: to assess the value of the estate and any tax due, to pay this tax to the authorities, and then distribute the assets of the estate. If appointed to this task by a valid will, they are 'executors'; if there is no valid will ('intestacy'), they are referred to as 'administrators'. In either case, they are required to obtained from the High Court an official document to show that they are the ones with legal authority to deal with the property; this is called the probate, or – in the case of administrators – a grant of letters of administration.[4] With this the personal representatives can call in any assets belonging to the estate held by other bodies – such as banks or insurance companies – before distributing them.

However, to obtain this document from the Probate Registry, personal representatives must provide an inventory of the estate, showing that any inheritance tax due has been paid (using an account form IHT200); as a standard consumer guide to wills and probate notes:

> In theory, you can be faced with an odd dilemma. On the one hand, no bank or insurance company which holds money belonging to the estate is willing to hand any of it to you until a grant of probate is obtained and produced to them; the probate is the only authority which can allow them to part with the money. On the other hand, you cannot obtain a grant of probate until you have actually paid the IHT, or at least most of it. How can you pay the tax, without being able to get your hands on the wherewithal to pay it?[5]

A number of qualifications should be made at this point.

First, probate is not required in cases where an estate has a value below £5,000. Second, under the 'excepted estates' regulations, personal representatives can obtain probate without delivering an account by swearing an oath that, amongst other things, the gross value of the estate is below the excepted estates threshold. In the past this has been set significantly below the level at which IHT becomes payable, to reduce the risk to tax revenue from errors by personal representatives in valuing an estate.[6] Finally, representatives who face this problem may be able to pay the outstanding tax if the deceased's estate includes certain types of asset (specifically, National Savings or British Government stock); they may also be in a position to apply to have the tax paid in instalments.[7]

Clearly the Exchequer benefits from the requirement on personal representatives to pay IHT at this point in the administration of an estate, as it minimises any risk that the assets might be distributed before any taxed owed on that estate has been paid. There will be benefits with respect to the costs of administering the tax as well.

Both factors were mentioned in a report on inheritance tax published by the National Audit Office (NAO) in March 1999 (the report refers to the Inland Revenue, which – at the time –

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4 In Scotland this is called 'confirmation'.

5 *Which? Guide to Wills and Probate*, 2007 p128

6 As an example, the excepted estates threshold was set at £240,000 from 1 August 2003 (SI 2003/1658), whereas the zero rate threshold was £255,000 for 2003-04. In 1997-98 there were 217,000 excepted estates (HC 251 1998-99 p 18).

7 See HMRC's guidance at: http://www.hmrc.gov.uk/inheritancetax/paying-iht/find-money-to-pay/index.htm

administered direct taxes only; it was merged with HM Customs & Excise in April 2005, to form HMRC):

> About 70% of IHT is self-computed and paid by the legal personal representatives when Inland Revenue Accounts are provided to obtain the grant of representation. The Capital Taxes Office's initial processing and general examination teams review these Accounts. More complex cases are referred to the Capital Taxes Office's special examination, compliance, technical advisory and enforcement units for advice and more detailed enquiries.
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> In well over half of the cases where the Inland Revenue Account shows tax is due, subsequent adjustments are made. Adjustments may also be necessary in cases where the legal personal representatives have declared no tax is due. Adjustments can arise for a variety of reasons, for example: following investigations made by the Capital Taxes Office; if the legal personal representatives receive new information about the deceased's estate or fail to take account of reliefs due; from modifications in asset values; and following the receipt of information about the deceased's income tax liabilities from the Inland Revenue's network of local tax offices.[8]

For its part the NAO did not recommend any change in this practice. In an earlier report on IHT in 1992 it had commented "the need for executors to obtain a grant of probate and the requirement to pay inheritance tax before probate is granted ensures that the majority of taxpayers comply with inheritance tax obligations."[9]

In an earlier report on IHT published in 1993, the Committee of Public Accounts raised concerns about the excepted estates procedure: in particular, that there might not be sufficient deterrent against abuse, given so much reliance was placed on the voluntary compliance of legal personal representatives, with no penalties for abuse.[10] The Inland Revenue responded to these concerns at the time, pointing out that the threshold figure for excepted estates was below the tax threshold and before deductions and exemptions, so there was a margin of safety between the excepted estates threshold and the tax threshold; that there was an obligation on the legal personal representatives to comply with the law; and, that they had no evidence that they were losing large amounts of tax from breaches of the procedures.[11] In its analysis of the work of the Capital Taxes Office, the NAO made the following conclusions on the excepted estates procedure:

> The work undertaken by the Capital Taxes Office on excepted estates in England and Wales has discovered some breaches of the procedures. Extrapolation of the work suggests that the estimated annual potential risk to tax amounts to as little as 0.1 per cent of the total inheritance tax yield. The value of the monitoring arrangements could be increased by targeting the work on higher-risk cases and by analysing the results to determine with a greater degree of precision the likely level of non-compliance and the impact of this on inheritance tax receipts.
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> The Capital Taxes Office is currently working towards refining the sample of cases on which it carries out checks. The National Audit Office welcomes the Capital Taxes Office's work in this area and recommends that, in refining its sampling methodology,

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8 HC 251 1998-99 p 9

9 *Inheritance tax*, 9 December 1992 HC 336 1992-93 pp 5-6

10 Committee of Public Accounts, *Inland Revenue: inheritance tax*, 27 October 1993 HC 688 1992-93 This report was on the basis of the 1992 NAO report cited above (HC 336 1992-93).

11 HC 251 1998-99 pp 18-19

> the Capital Taxes Office should establish a framework which it could use to extrapolate the results and provide increased assurance that errors, or abuse of the excepted estates procedures, are not leading to a material loss of tax revenue. This information could also be used to validate its current assessment of the risks involved with these arrangements.[12]

During the proceedings of the Finance Bill in June 2002 Howard Flight MP put down a new clause with a view to enable personal representatives to pay IHT out of the estate remaining after death before probate was granted. As Mr Flight explained, "this is really a probing new clause, to point out that that is how the matter often operates and ask whether there is any particular reason for the existing requirements, or whether it is just a historic anomaly." In response the then Financial Secretary Ruth Kelly acknowledged that this was a problem and that the Government were exploring solutions to deal with it:

> I thank the hon. Member for Arundel and South Downs for the constructive manner in which he has put his proposal and raised the issues. I accept that there is a case here, but there is a problem with the new clause, which I do not think actually deals with the issue in point. Although it states what executors can use, it does not oblige anyone else to let them have it. The issue is not just about tax law, but is a matter of the general law surrounding the administration of estates. It is not something that we can change at a stroke through amending the Inheritance Tax Act 1984.
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> That said, I think that the Committee will understand that we are interested in resolving those issues. We are working on them in close consultation with bank and building society representative bodies. The key is to address the concerns that such third parties have about releasing assets before they can be assured that the would-be executors have the authority, in the form of a completed grant of probate, to direct what should be done with them. We think that that can be done through an arrangement that asks banks and other deposit takers to release funds only if they go directly to an Inland Revenue account to pay inheritance tax. That would cover the intermediary against potential exposure to paying out a second time in the unlikely event that the process goes wrong in some way.
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> The hon. Gentleman will understand that it takes time to negotiate and implement new arrangements with which all concerned can feel comfortable. I hope very much that we can make some concrete announcements before long and I ask the hon. Gentleman to withdraw his new clause.[13]

In January 2003 the then Paymaster General, Dawn Primarolo, made a written statement, announcing the introduction of a direct payment scheme later that year:

> In proceedings in Finance Bill Standing Committee on 25 June we announced that work was in hand to allow inheritance tax to be paid out of an estate before probate is granted. We have now reached agreement in principle with the British Bankers' Association and the Building Societies' Association on a direct payment scheme for Inheritance Tax. Broadly, where the deceased person has sufficient funds to their credit, participating institutions will be ready to transfer funds direct to the Inland Revenue to pay the inheritance tax due. We are now working with the Associations to finalise the detail of the processes concerned, and help their members prepare for the

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[12] HC 251 1998-99 p 23

[13] SC Deb (F) 25 June 2002 c 578. Mr Flight welcomed this announcement and withdrew the new clause.

> launch. The Government hope to see the maximum possible take up of this welcome scheme which will start later this year.[14]

The scheme was launched on 31 March 2003; details were given in a press notice, part of which is reproduced below:

> From Monday 31 March, participating institutions will accept instructions from personal representatives to make the initial payment of IHT by electronic transfer. The amount of the payment from the institution concerned will be limited to the lesser of the amount due and the net credit balance in the deceased's account(s) at the date of death. The scheme is voluntary on the part of the institutions and some will want to carry on with their existing informal arrangements and make such payments by cheque.
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> The arrangements are straightforward and intended to work with the minimum of bureaucracy. Personal representatives will get the necessary forms and guidance as part of their basic package of material for the IHT account (IHT200). If they want to take advantage of the direct payment facility they will initiate it as part of the process of completing the account.
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> Broadly the scheme works as follows. Personal representatives will need to check with the institution(s) holding the deceased's funds to see if they are taking part. If so, the personal representatives will then contact us, in writing or by telephone (see below for details), for the IHT reference number allocated to the estate. When the personal representatives are ready to apply for a grant they will send the form(s) of authority to the relevant institution(s). They in turn will transfer the funds and pay the tax electronically. Once we have received the payment(s) we will, as we do now, provide the personal representatives with a receipt for the total amount paid for presentation to the Court Service to obtain the grant.[15]

Further details of the scheme are published on HMRC's site.[16] A new helpline was set up at this time – a joint initiative of the tax authorities and the Court Service – to provide advice for those dealing with probate and IHT issues. The number is 0845 3020900; it is open from 9am to 5pm Monday to Friday, and calls are charged at local call rates.[17]

In August 2005 HMRC gave some details of the operation of the scheme:

> Now that this scheme is fully established as a way of paying Inheritance Tax we are keen to ensure that it remains as easy to use as possible. Our recent customer survey shows that an increasing number of our customers (over 66%) are now paying their tax directly from the deceased's bank or building society accounts. This is not necessarily through our scheme, as many banks and building societies operate independent schemes of their own, but it does demonstrate that this is becoming an easier way to pay. Awareness among our customers of this method of payment has also increased as well. We have worked with the British Bankers' Association and The Building Societies Association to continue to improve in this area and have undertaken to let them know of difficulties that our customers come across with their

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14 HC Deb 21 January 2003 c 5WS
15 Inland Revenue press notice 11/03, 27 March 2003
16 http://www.hmrc.gov.uk/inheritancetax/paying-iht/find-money-to-pay/direct-payment-scheme.htm
17 Inland Revenue press notice 14/03, 4 April 2003

> members. We are pleased that these problems now seem to be few and far between.[18]

In a report on IHT in July 2005 the Public Accounts Committee commented on the scheme as follows:

> The Probate Service does not grant probate until Inheritance Tax due is paid. This is an important safeguard in ensuring tax returns are submitted, but representatives have often needed a loan to pay the tax, with the interest costs met from the estate after probate. To alleviate this, the Revenue allows payment by instalment of the tax due on property and some other assets. Since 2003 representatives have also been able to use funds held in an estate's bank accounts to pay the tax due before obtaining probate. Some estates may nevertheless have insufficient liquid assets for representatives to pay the tax in advance of probate, if for example the main asset is the family home. The Revenue considers that estates usually do have enough liquidity to pay the tax due, but it has not analysed those potentially affected.[19]

The Committee recommended that HMRC should review the extent of the problem, and in the Treasury's response to the report – published in October 2005 – it was stated that, "HMRC accepts this recommendation and work has already started on this review."[20]

2 New procedures for IHT returns

In the 2004 Budget the Government announced changes to simplify the requirements for estates to complete a full IHT return. As noted above, under the 'excepted estates' regulations, personal representatives can obtain probate without delivering an account by swearing an oath that, amongst other things, the gross value of the estate is below the excepted estates threshold – which was then set at £240,000. (The zero-rate threshold was set at £263,000 for 2004-05.) It was proposed that other than in the largest estates (and a small number of other exceptions), an IHT account will be required only where there was tax to pay, bringing a further 30,000 estates a year under the regime. Details were given in a Budget Notice, an extract from which is given below:

> The Inheritance Tax (Delivery of Accounts) (Excepted Estates) Regulations 2002 (SI 2002 No. 1733) (as amended by SI 2003 No.1658) specify the circumstances in which an IHT account can be dispensed with. In such estates, very limited information is delivered to the Probate Service with the application for a grant of probate. To monitor the process, the Inland Revenue ask for a full account to be completed in a small number of these estates.
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> The new processes will ensure that basic information about the vast majority of estates is provided to Government only once and passed as necessary between the Probate Service and Inland Revenue. The numbers of estates that have to complete a full account will be substantially reduced as a result. Exactly what information should be provided and how that may vary in some cases will be discussed with interested parties before the changes are made to the Regulations later this year. The Inland Revenue will continue to make enquiries in any cases deserving further enquiry. In

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18 HMRC, *IHT newsletter*, August 2005 p 1

19 *Twenty-ninth report: Inheritance tax*, 12 July 2005 HC 174 2004-05 p 14

20 *Treasury minutes on the 23rd, & 25th-30th reports*, Cm 6668 October 2005 p 25

> Scotland, the Inventory which is already delivered to the Scottish Court Service in every estate will contain some further information about the estate for IHT purposes. Provision will be made to allow for the information delivered via the Probate Service to be treated as having been furnished direct to the Inland Revenue. This means that the current penalty rules for delivery of incorrect information will apply to information delivered to the Inland Revenue via the Probate Service. The changes will apply similarly to information delivered via the Scottish Court Service.
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> To bring the IHT penalty rules more in line with those for Income and Capital Gains taxes provision will be made:
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> - for a penalty to be charged (up to £3,000) for failure to submit an IHT account, or to notify the Inland Revenue if a disposition on death is varied, within 12 months of the account or notification being due;
> - to change the current penalty provisions by removing the penalty charge where no additional IHT arises as a result of negligent or fraudulent material submitted to the Inland Revenue;
> - to fix the penalty charge at £100 for the late delivery of an IHT account unless the tax involved is less than that amount or there is a reasonable excuse …
>
> **Operative date** The detailed changes to the simplified reporting process will be discussed with interested parties and the necessary changes to secondary legislation will be made later this year. The changes to the penalty rules will take effect from Royal Assent, with suitable transitional provisions.[21]

The new rules – set out in the *Inheritance Tax (Delivery of Accounts) (Excepted Estates) Regulations* SI 2004/2543 – came into force on 1 November 2004. The Revenue's memorandum on the Order gives the following explanation:

> The changes now being introduced in these Regulations for deaths on or after 6 April 2004 do two main things. First they add a new category of estates which qualify as excepted estates bringing an extra 30,000 estates a year into the simpler reporting regime. Amendments are also made to the existing category of excepted estate in relation to persons domiciled in the United Kingdom. Second they specify the information which must be delivered to the Board of Inland Revenue by excepted estates and to whom it must be produced. As well as reducing the administrative burden for the 30,000 extra estates a year mentioned the changes result in a uniform reporting system for all excepted estates which will be much more straightforward to operate.
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> Personal representatives will fill in a straightforward return with information about the assets and value of the estate as part of their application for Probate/Confirmation. They will send it to the Court Service and the information will then be passed on to the Inland Revenue where it will be treated in exactly the same way as information delivered direct by personal representatives. The changes, in effect, result in a one–stop–shop for personal representatives of excepted estates. They will be able to meet their IHT and Probate/Confirmation obligations by contact with a single government department – the Court Service.[22]

During the report stage of the Finance Bill in July 2005, Philip Hammond MP put down two new clauses, to relieve the representatives of excepted estates of the requirement to make this new return – known as IHT205. The Member argued that the new reporting obligation

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[21] Inland Revenue Budget Notice REV BN32, 17 March 2004

[22] Inland Revenue, *Explanatory memorandum relating to … SI 2004/2543*, September 2004 paras 6.4-6.6

placed on all those estates below the IHT threshold – some 300,000 in total – was over-bureaucratic, intrusive and onerous:

> I have a copy of form IHT205 in front of me. It is a four-page document in the typical style of a tax return. It is laden with complicated and intrusive questions—so much so that there are 23 pages of accompanying guidance notes and 16 pages of annexes. … This is a massive and intrusive fishing expedition that involves trawling, collecting and storing information—in minute detail—on those who are supposed to be outside this particular tax net and free of the hassle of compliance. It turns on its head the previously accepted position that the details of an estate below the IHT threshold were not a matter for the Revenue … It is our contention that people who are dealing with modest estates—of as little as £7,000 to £10,000, and thus way below the inheritance tax threshold—should not be subjected to this additional burden at a time of bereavement or have to waste time and money completing a form whose only point is to feed the seemingly insatiable desire of the big brother state for information on every aspect of our lives.[23]

However the Paymaster General opposed the change, arguing that "the uniformity the Government that built into the system in 2004 strikes the right balance"; the Minister set out the rationale for the new system in some detail:

> It may help the House if I briefly describe the probate and IHT reporting system as it stood before the changes made in 2004. Estates fell into three broad categories for reporting purposes. If the estate was worth more than £240,000, a full IHT return was required—not the short form in use at present. If the estate was worth less than £240,000 and the executor was a personal applicant, they had to fill in a short form very much like the one in use now. If the estate was worth less than £240,000 but a solicitor was acting for the executor, the executor simply had to swear an oath that the estate was worth £X,000 to demonstrate that it qualified for the excepted estates procedure. Under the old rules many executors had to fill in a full IHT return even though the estate paid no tax. The Government changed the rules last year primarily to bring most of those cases—about 30,000—into the excepted estates procedure, thereby reducing their compliance costs whether or not they were represented by solicitors. We moved them from the more complicated system to the excepted estates procedure. However, extending that procedure to bring in many more cases, many of them much bigger than those that were previously clearly eligible, increases the risk of non-compliance; so in striking the right balance, the Government took the opportunity to streamline the detailed procedure, improve co-ordination between HMRC and the Court Service, and update IHT protection against non-compliance.
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> As part of that process, the Government unified the two existing procedures for executors using the excepted estates procedure, so that they all now fill in the same short form whether or not they are advised by a solicitor. As I said, the form contains the minimum number of questions needed to show that the estate is entitled to use the excepted estates procedure and to allow HMRC to make a risk assessment.[24]

The Minister went on to explain why the Government opposed these changes:

> The new clauses seem intended to reverse all those changes, so that some or all executors would be entitled to claim access to the excepted estates procedure without giving even basic information about the facts that would justify their using it. The

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[23] HC Deb 6 July 2005 cc 312-3

[24] HC Deb 6 July 2006 c 320, c 319

> Government's view is that that is misconceived. To qualify for the excepted estates procedure, executors have always been required to know the total value of the estate and key points about what it contains, and solicitors will always have to establish those basic facts.
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> The form that executors must now fill in only sets out systematically the questions that solicitors have been asking their clients already, before putting them through the excepted estates procedure. They are already collecting such information to satisfy themselves that their clients could use the excepted estates procedure. To be fair to solicitors, the overwhelmingly majority of them clearly took those obligations seriously. However, there have been indications that there were issues on different occasions, but none has been demonstrated with the new procedure.[25]

Since then, the issue does not appear to have been debated in the House.

[25] HC Deb 6 July 2006 cc 319-320. The House voted against the new clauses: 276 votes to 181.