Death and taxes

Inheritance tax and trusts



06 May 2021

Lisa Spearman considers some practi cal steps for executors and their advisors following a death, and for the testator to take beforehand

Key Points

What is the issue?
The will is only one part of dealing with an estate. In the event of a death, some practical steps might make the process easier if they are thought about in advance.

What does it mean for me?

There are a range of issues to consider, including bank accounts and cash management, life insurance, valuation of assets, income tax and capital gains tax reporting, unintended effects and lifetime gifts and normal expenditure out of income.

What can I take away?

The importance of accurate and current estate accounts cannot be overstated. For valuable, complex or contentious estates, estate accounts are the executor's best tool for ensuring that the administration is concluded in a timely manner.

The events of the last year have focused our minds, leading many people to review or write their wills. However, the will is only one part of dealing with an estate. Here are some practical tips to bear in mind in the event of a death, and some steps to consider which might make the process easier if they are thought about in advance: perhaps at the point of writing the will.

General

There is useful basic guide on what to do when someone dies on the Gov.uk website (see bit.ly/2OEutak). There is a useful 'Tell us once' service to inform most government departments that someone has died; this is initiated with a code from the registrar (see bit.ly/3fVEPhe). There is also a guide to probate, how to value the estate and how to register a jointly owned property in the sole name of the survivor.

It is sensible to pay for multiple copies of the death certificate and, when granted, the probate grant, as these will need to be sent to a wide range of businesses and financial institutions. It may also be helpful to obtain certified copies of the will. The original will must be sent to the Probate Registry, but some financial institutions ask to see the will before making payments to the executor.

1. Bank accounts and cash management

The assets of the deceased are frozen until probate is granted. Most banks will allow funds to be accessed to pay the probate fees and inheritance tax, and some will allow funeral costs too. In addition, regular direct debits and standing orders will be stopped. This can be helpful as having a direct debit payment stopped will usually cause the provider to make contact, which will assist in identi fying anything which

has been missed; online subscripti ons and PayPal, for example, are easily overlooked. The deceased’s outstanding bills, such as utilities and care fees, will not be paid by banks. Some banks may close accounts and pay small amounts direct to the executor without the need for probate but this is a variable practice.

It is wise to set up an executor’s account as soon as practi cal to receive income and proceeds of sale from the estate in due course.

In estates where there are large ongoing costs of maintenance and perhaps a payroll, it can be helpful for the testator to declare a bare trust in lifeti me over a sum of money with the will-be executor as trustee. Be aware that a joint signing authority or power of attorney will not stop the bank account freezing (although a joint account will pass directly to the other account holder). These funds can then be accessed in the pre-grant period.

2. Funding inheritance tax

Ideally, liquidity planning and estimated inheritance tax computations should be a routi ne part of later-life financial reviews to avoid cash flow difficulties. Inheritance tax must be paid within six months of the death. Investment managers may be able to sell investments to raise cash. Borrowing can be an option but could be expensive, whilst being difficult to put in place in terms of administration. In theory, HMRC can allow time to pay if there are no other means of funding the tax in advance of the grant of probate but it is not often keen to do so. If you have liquidity concerns, they should be identified and addressed early.

Proof of a transferable nil-rate band and residenti al nil-rate bands can be hard to establish post death. It is always useful on the first death to ensure that informati on is retained and accessible. While a later claim can be made on the corrective account, holding proof on nil-rate bands could enable a sizeable cash flow saving.

As an aside, evidence of non-English law marriages can be particularly challenging to find. I have worked on a case where HMRC asked for wedding photographs from 60 years ago!

3. Premium bonds pensions and life insurance

One may think that a simple estate passing to the surviving spouse might not need a grant of probate. I was shocked, though, to find that we had to obtain a grant of

probate to redeem premium bonds. Be aware if you have an estate including premium bonds which may not otherwise need a grant.

Pensions (especially undrawn ones) and life insurance can sometimes be difficult to track down and claim. You can ensure that your savings and investments are properly accessed if – while you are still here – you keep a list of policy numbers and providers alongside a copy of your will.

4. Self-employment, partnerships and staff on payroll

Where an individual is self-employed, in partnership and/or has staff (including domestic staff), it is important to have a plan in place to either keep the business going or to wind down in an orderly manner. The staff will not be thrilled if they go unpaid and technically the death of an unincorporated employer is a statutory redundancy event. One might think that this is a relatively common event and would be easy to deal with, but recent cases we have dealt with have shown that the real time information (RTI) system does not factor this in well; transfer of payroll can be difficult and employment law issues can arise.

If a business maintenance plan is in place – particularly if combined with cash flow planning as above – it can be very helpful. It’s important that someone other than the business owner knows what to do and how to contact customers, as well as handling VAT and payroll. Make sure the business protection insurance policies are in place and are to hand.

5. Valuation of assets

The executors are required to value assets to the best of their knowledge and belief. An insurance inventory can be a good place to start in terms of establishing a headline value of chattels and sites such as Zoopla can offer clues to property values (useful for liquidity planning). If there is any question as to inheritance tax being payable, however, the executor should instruct an appropriately qualified valuer.

Quoted investments are straightforward enough but other assets may require professional assistance – such as unquoted assets (a chartered accountant), real property (an estate agent) and chattels and personal effects (an auction house). One would hope that art, jewellery or similar items of value or significance have been identified during the deceased’s lifetime, but executors can find surprises.

6. Business assets

If the deceased has shares in an unquoted company or has other business assets, a valuation will be needed for probate purposes and to form the base cost for capital gains tax purposes for the heirs. One might assume that as 100% business property relief applies for inheritance tax, that will suffice. Be aware of the excepted assets trap, however. It is not uncommon for a business to be less active than it was in the deceased's earlier life. If there are assets on the balance sheet not used for business purposes in the prior two years and not required for the future, business property relief on these assets will be denied. Cash and real property are frequent off enders.

The 'wholly or mainly' trading question can also be a trap. It is wise to ensure that annual accounts preparation includes a commentary on any assets on the balance sheet which might fall into this category, so that there is contemporaneous evidence of use and purpose, should the worst happen. If contemporaneous evidence is not available, the executors will have to reconstruct evidence from the available evidence to claim full business property relief.

7. Income tax and capital gains tax reporting

The timing of the death can have a significant effect on the complexity and duration of bringing matters to a close, depending on when it falls in a tax year. Income tax and capital gains tax due before probate is granted are automatically deferred until 30 days after the grant. However, the HMRC computer does not always know that, and you can get demands for payment. Similarly, if a tax return due on 31 January cannot be filed, make sure that HMRC is aware of the circumstances.

There are some traps: watch out for accrued income, life insurance chargeable events and some deferred gains which may become taxable as at the date of death. If a business has come to an end, cessation rules might operate. It may be possible to conclude the deceased's affairs and those of the estate by informal procedures. HMRC publishes the criteria for this at bit.ly/3u4hH3W. Don't overlook the requirement to register on the Trust Registrati on Service.

Finally, note that sales of residential property must be reported within 30 days of completion. This is onerous for executors and needs particular care. It is also important to understand whether the seller is the estate or the heirs. In the latter case, several returns may be required and there are penalties for late filing.

8. Unintended effects

Executors often find themselves involved if a trust is created, or comes to an end, as a result of the death. In the case of a trust ending, there may be a tax liability (particularly if it is a non-UK trust).

On creation of a will trust, executors oft en become the trustees, and will need to be conscious of which hat they are wearing and of different reporting obligations.

9. Lifetime gifts and normal expenditure out of income

Keeping a record of significant lifetime gifts is always helpful. Executors may have to go back 14 years to establish the correct inheritance tax position, and it is a dedicated squirrel who retains bank statements for that long. Giving away surplus income is effective inheritance tax planning but only if your executors can prove it. It is necessary to show that year-on-year, there was a pattern of giving and that the gifts were made from income without reducing the deceased's normal standard of living.

Many of my clients complete p8 of form IHT 403 annually as a useful way of recording the information needed in the relevant format, whilst identifying the likelihood of the relief being denied while there is still time to do something about it. See bit.ly/3m4uslY.

10. Estate accounts

I'm an accountant, so I would say this – but the importance of accurate and current estate accounts cannot be overstated. For valuable, complex or contentious estates, estate accounts are the executor's best tool for protecting themselves from challenge and ensuring that the administration is properly and completely concluded in a timely manner.