

Inheritance Tax: Reduced Rate for Estates Leaving 10 Per Cent or More to Charity

Who is likely to be affected?

This measure will primarily affect people who are considering leaving, or who have already left, a charitable legacy in their will. The personal representatives of people who have died and the beneficiaries of their estates may also be affected. Solicitors, estate practitioners, accountants and other professional advisers who deal with or advise on wills, estates and inheritance tax (IHT) will also be affected.

General description of the measure

Legislation will be introduced in Finance Bill 2012 to provide for a reduction in the rate of IHT from 40 per cent to 36 per cent where 10 per cent or more of a deceased person's net estate (after deducting IHT exemptions, reliefs and the nil-rate band) is left to charity. The measure will apply to deaths on or after 6 April 2012.

Policy objective

This policy supports the Government's aim to encourage charitable giving, promote greater philanthropy, and links into the Government's objective of fairness in the tax system. The aim of the policy is to act as an incentive for people to make charitable legacies, or to increase existing legacies, and so increase the amount charities receive from estates.

Background to the measure

At Budget 2011 the Chancellor of the Exchequer announced a package of measures to support philanthropy and encourage charitable giving by donors at all life stages. A consultation document, *A new incentive for charitable legacies*, was published on 10 June 2011 on the HMRC website. The Government has considered all responses received to the consultation, as detailed in the summary of responses published on 6 December 2011.

Detailed proposal

Operative date

The measure will have effect for deaths on or after 6 April 2012.

Current law

On death, IHT is charged on estates where the net value is more than the IHT threshold or 'nil-rate band' (currently £325,000 but the amount available for use by an estate can be different in some circumstances).

A person's estate for IHT purposes includes not only the assets that they directly owned immediately before their death and which they are able to dispose of under the terms of their will (their 'free estate') but also certain other assets and property. These include jointly owned assets which pass automatically to the surviving joint owner, interests in certain types of trust (settled property), and some other assets which the individual gave away during their lifetime whilst continuing to derive a benefit (gifts with reservation of benefit). All these different categories of asset combine to form an aggregate estate that is subject to IHT.

This aggregate estate is reduced by a number of reliefs and exemptions. For example, assets passing to a spouse or civil partner are exempt, and certain business assets may qualify for business property relief. Gifts made to qualifying charities are exempt from IHT. After deducting the various reliefs and exemptions most estates are below the available nil-rate band and so are not liable to IHT.

IHT is charged at a single rate of 40 per cent on the net chargeable value of an estate (after reliefs and exemptions have been deducted) over the available nil-rate band.

The distribution of a deceased's estate can be altered after death by executing an Instrument of Variation if the relevant beneficiaries agree. Where beneficiaries redirect all or part of their inheritance to charity, they can elect for those charitable gifts to be treated for IHT purposes as if they were made from the deceased's estate. This applies not only to assets passing under the deceased's will, but also to assets passing under the intestacy rules and to jointly owned assets passing to the surviving joint owner.

Proposed revisions

Legislation will be introduced in Finance Bill 2012 so that for deaths on or after 6 April 2012 IHT will be charged on the net chargeable value of an estate at a rate of 36 per cent where 10 per cent or more of that estate has been left to charity.

Where the estate comprises only the deceased's 'free estate', the value of the estate on which the 10 per cent threshold will be based (the 'baseline') will be the value of the net estate charged to IHT after deducting all available reliefs, exemptions and available nil-rate band, but excluding the charitable legacy itself. The total amount of charitable legacies will be compared with the baseline amount to see if the estate qualifies for the reduced IHT rate (the '10 per cent test').

In cases in which the IHT estate includes assets additional to those in the 'free estate', the 10 per cent test will be applied to each category of assets (or component) that makes up the aggregate estate such as the 'free estate', jointly owned assets and settled property. If the assets passing to charity from one component exceed 10 per cent of the baseline, other components may be merged with it to give an aggregate baseline. The value of the assets passing to charity from a particular component will be compared to the baseline amount for that component. If the 10 per cent test for a component is passed, IHT will be charged on that particular component at 36 per cent.

The reduced rate of IHT will apply automatically if the estate or component passes the 10 per cent test. If it does not, IHT will be charged at the full rate. However, personal representatives and other relevant persons will be able to elect for the reduced rate not to apply if, for example, the benefit obtained from applying the reduced rate is likely to be minimal and they do not wish to incur additional costs of valuing items left to charity.

The new provisions will apply equally to charitable legacies made by will or by an Instrument of Variation. The conditions for an Instrument of Variation to be taken into account for IHT purposes will be amended so that the reduced rate will only apply if it is shown that the charity has been notified that the devolution of the estate has been varied in its favour.

Summary of impacts

This summary is based on a number of assumptions about how people will respond to the new rules, including the extent and speed of take-up. The impacts may vary depending on those assumptions and eventual policy implementation.

Exchequer impact (£m)	2011-12	2012-13	2013-14	2014-15	2015-16
	<p>The figures were set out in Table 2.1 of Budget 2011. In addition, further changes were made to assumptions as a result of consultation, therefore the measure is now expected to decrease receipts to the Exchequer by approximately £60 million per annum. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2012.</p>				
Economic impact	<p>This measure has no significant economic impacts.</p>				
Impact on individuals and households	<p>The measure will have some impact on individuals and households. However, most estates are not liable to IHT because their value after any reliefs and exemptions is less than the available nil-rate band. Only estates liable to IHT will be directly affected by this measure. The number of these is relatively low and is forecast to be 16,000 in 2010-11 or about 3 per cent of the total number of death estates.</p> <p>The number of estates where the amount that is left to charity is changed as a result of this measure is highly uncertain. The assumption is that the number of estates where a person will die and increase the amount they leave to charity to 10 per cent will be about 50 in 2012-13, increasing to about 200 in 2013-14, 600 in 2014-15, 1,000 in 2015-16, and eventually to about 5,000. The take up will depend on the extent to which the reduced rate is promoted by charities and by professional advisers.</p> <p>The measure may affect people who are considering leaving a charitable legacy when they die, or who have already left an amount to charity in their will, and whose estates are liable to IHT. Such individuals will need to be aware of the proposed changes when they are making their will, or if they wish to amend an existing will. To benefit from the reduced IHT rate, some wills might need to be changed, with associated administrative costs to testators, although wills may be reviewed for other reasons and changed as part of that review. The use of standard clauses in wills to ensure that the estate benefits from the reduced rate if appropriate amounts are left to charity would minimise additional costs to testators.</p> <p>The measure may also affect executors, personal representatives, and beneficiaries of a deceased's estate where IHT is due. Beneficiaries may consider submitting Instruments of Variation to take advantage of the reduced rate of IHT. The measure may also have an impact on solicitors, estate practitioners and other professional advisers who have been appointed as executors of estates.</p>				
Equalities impacts	<p>The gender split for those whose estates become liable for IHT is around 60 per cent female and 40 per cent male. This is because, for married couples, IHT generally becomes due on the second death, which is more likely to be the wife. However, the administrative impact of this measure is not on the deceased person leaving the estate but rather on those acting as executors or administrators of the estate.</p> <p>This measure is not expected to have any impacts on any other protected equality group.</p>				

<p>Impact on business including civil society organisations</p>	<p>There will be an impact on software providers who will have to update substitute IHT forms and the software they supply. Solicitors, estate practitioners and other professional advisers may also incur one-off costs of familiarisation, training and software updates. These one-off costs are unknown as the consultation did not provide any evidence.</p> <p>It is assumed that charities will benefit from this change. The additional revenue that this measure is expected to raise for charity up to 2016-17 is on average approximately £40 million per annum. These estimates are based on an assessment of the number of estates which are assumed to increase their legacies to charity as a result of the measure, and so are also uncertain. As charities will not receive any additional revenue until after the estate has gone through probate and paid the tax, it will take longer for charities to receive the additional revenue than for the measure to impact on the Exchequer.</p> <p>The average increase in the amount left to charity is assumed to eventually be around £60,000. It is assumed that many estates will increase the amount left to charity by much less than this but the average is higher due to a small number of large estates.</p> <p>There are over 300,000 charities in the UK. All of these, and certain European charities, could potentially benefit, although it is not known how many will be left additional legacies as a result of this measure in any given year. Some of these charities may wish to be aware of the change and understand the new rules so that they can encourage people to leave legacies in their wills or increase the amount already left to charity. The expected additional revenue will depend partly on the extent that charities promote this measure to potential donors.</p>
<p>Operational impact (£m) (HMRC or other)</p>	<p>Changes will be needed to IHT forms, guidance, and the IHT computer system. Additional contact is expected from customers to the Probate & IHT Helpline and increases are expected to the processing work involved with IHT forms by staff. There may be increased risk assessment and compliance activity. Operational and IT change costs are estimated to be £2.23 million for the first five years although these will be subject to change depending on final implementation.</p>
<p>Other impacts</p>	<p>No other impacts have been identified.</p>

Monitoring and evaluation

The impact of the reduced rate on the amount left to charity by IHT taxpayers will be monitored from information collected through IHT returns.

Further advice

If you have any questions about this change, please contact Danka Wigley on 020 7147 3674 or by email: danka.wigley@hmrc.gsi.gov.uk.

1 Inheritance tax: gifts to charities etc

Schedule 1 contains provision for a lower rate of inheritance tax to be charged on transfers made on death that include sufficient gifts to charities or registered clubs.

SCHEDULE 1

Section 1

INHERITANCE TAX: GIFTS TO CHARITIES ETC

Reduced rate of inheritance tax

1 After Schedule 1 to IHTA 1984 insert –

“SCHEDULE 1A

GIFTS TO CHARITIES ETC: TAX CHARGED AT LOWER RATE

Application of this Schedule

- 1 (1) This Schedule applies if –
 - (a) a chargeable transfer is made (under section 4) on the death of a person (“D”), and
 - (b) all or part of the value transferred by the chargeable transfer is chargeable to tax at a rate other than nil per cent.
- (2) The part of the value transferred that is chargeable to tax at a rate other than nil per cent is referred to in this Schedule as “TP”.

The relief

- 2 (1) If the charitable giving condition is met –
 - (a) the tax charged on the part of TP that qualifies for the lower rate of tax is to be charged at the lower rate of tax, and
 - (b) the tax charged on any remaining part of TP is to be charged at the rate at which it would (but for this Schedule) have been charged on the whole of TP in accordance with section 7.
- (2) For the purposes of this paragraph, the charitable giving condition is met if, for one or more components of the estate (taking each component separately), the donated amount is at least 10% of the baseline amount.
- (3) Paragraph 3 defines the components of the estate.
- (4) Paragraphs 4 and 5 explain how to calculate the donated amount and the baseline amount for each component.
- (5) The part of TP that “qualifies for the lower rate of tax” is the part attributable to all the property in each of the components for which the donated amount is at least 10% of the baseline amount.
- (6) The lower rate of tax is 36%.

The components of the estate

- 3 (1) For the purposes of paragraph 2, the components of the estate are—
- (a) the survivorship component,
 - (b) the settled property component, and
 - (c) the general component.
- (2) The survivorship component is made up of all the property comprised in the estate that, immediately before D's death, was joint (or common) property liable to pass on D's death—
- (a) by survivorship (in England and Wales or Northern Ireland),
 - (b) under a special destination (in Scotland), or
 - (c) by or under anything corresponding to survivorship or a special destination under the law of a country or territory outside the United Kingdom.
- (3) The settled property component is made up of all the settled property comprised in the estate in which an interest in possession subsists to which D was beneficially entitled immediately before death.
- (4) The general component is made up of all the property comprised in the estate other than—
- (a) property in the survivorship component,
 - (b) property in the settled property component, and
 - (c) property that is treated under section 102(3) of the Finance Act 1986 (gifts with reservation) as property to which D was beneficially entitled immediately before death.

The donated amount

- 4 The donated amount, for a component of the estate, is so much of the value transferred by the relevant transfer as (in total) is attributable to property that—
- (a) forms part of that component, and
 - (b) is property in relation to which section 23(1) applies.

The baseline amount

- 5 The baseline amount, for a component of the estate, is the amount calculated in accordance with the following steps—

Step 1

Determine the part of the value transferred by the chargeable transfer that is attributable to property in that component.

Step 2

Deduct from the amount determined under Step 1 the appropriate proportion of the available nil-rate band.

“The appropriate proportion” is a proportion equal to the proportion that the amount determined under Step 1 bears to the value transferred by the chargeable transfer as a whole.

“The available nil-rate band” is the amount (if any) by which –

- (a) the nil-rate band maximum (increased, where applicable, in accordance with section 8A), exceeds
- (b) the sum of the values transferred by previous chargeable transfers made by D in the period of 7 years ending with the date of the relevant transfer.

Step 3

Add to the amount determined under Step 2 an amount equal to so much of the value transferred by the relevant transfer as (in total) is attributable to property that –

- (a) forms part of that component, and
- (b) is property in relation to which section 23(1) applies.

The result is the baseline amount for that component.

Rules for determining whether charitable giving condition is met

- 6 (1) For the purpose of calculating the donated amount and the baseline amount, any amount to be arrived at in accordance with section 38(3) or (5) is to be arrived at assuming the rate of tax is the lower rate of tax (see paragraph 2(6)).
- (2) Section 39A does not apply in calculating the donated amount (but it does apply in calculating the baseline amount).
- (3) Subject to sub-paragraphs (1) and (2), the provisions of this Act apply for the purpose of calculating the donated amount and the baseline amount as for the purpose of calculating the tax to be charged on the value transferred by the chargeable transfer.

Election to merge components

- 7 (1) An election may be made under this paragraph if, for a component of the estate, the donated amount is at least 10% of the baseline amount.
- (2) That component is referred to as “the qualifying component”.
- (3) The effect of the election is that the qualifying component and one or both of the other components of the estate (as specified in the election) are to be treated for the purposes of this Schedule as if they were a single component.
- (4) Accordingly, if the donated amount for that deemed single component is at least 10% of the baseline amount for it, the property in that component is to be included in the part of TP that qualifies for the lower rate of tax.

- (5) The election must be made by all those who are appropriate persons with respect to each of the components to be treated as a single component.
- (6) “Appropriate persons” means –
 - (a) with respect to the survivorship component, all those to whom the property in that component passes on D’s death (or, if they have subsequently died, their personal representatives),
 - (b) with respect to the settled property component, the trustees of all the settled property in that component, and
 - (c) with respect to the general component, all the personal representatives of D or, if there are none, all those who are liable for the tax attributable to the property in that component.

Opting out

- 8 (1) If an election is made under this paragraph in relation to a component of the estate, this Schedule is to apply as if the donated amount for that component were less than 10% of the baseline amount for it (whether or not it actually is).
- (2) The election must be made by all those who are appropriate persons (as defined in paragraph 7(6)) with respect to the component.

Elections: procedure

- 9 (1) An election under this Schedule must be made by notice in writing to HMRC within two years after D’s death.
- (2) An election under this Schedule may be withdrawn by notice in writing to HMRC given –
 - (a) by all those who would be entitled to make such an election, and
 - (b) no later than the end of the period of two years and one month after D’s death.
- (3) An officer of Revenue and Customs may agree in a particular case to extend the time limit in sub-paragraph (1) or (2)(b) by such period as the officer may allow.

General interpretation

- 10 In this Schedule, in relation to D –
 - “the chargeable transfer” means the chargeable transfer mentioned in paragraph 1(1);
 - “the estate” means D’s estate immediately before death;
 - “the relevant transfer” means the transfer of value that D is treated (under section 4) as having made immediately before death.”

Consequential amendments

- 2 IHTA 1984 is amended as follows in consequence of paragraph 1.
- 3 In section 7 (rates), in subsection (1), after “(4) and (5) below” insert “and to Schedule 1A”.
- 4 In section 33 (amount of charge under section 32), after subsection (2) insert –
 - “(2ZA) In determining for the purposes of subsection (1)(b)(ii) the rate or rates that would have applied in accordance with subsection (1) of section 7, the effect of Schedule 1A (if it would have applied) is to be disregarded.”
- 5 In section 78 (conditionally exempt occasion), in subsection (3), for “33(3)” substitute “33(2ZA)”.
- 6 In section 128 (rate of charge: woodlands) –
 - (a) the existing provisions become subsection (1) of that section, and
 - (b) after that subsection insert –
 - “(2) In determining for the purposes of subsection (1) the rate or rates at which tax would have been charged on the amount determined under section 127, the effect of Schedule 1A (if it would have applied) is to be disregarded.”
- 7 After section 141 insert –

“141A Apportionment of relief under section 141

- (1) This section applies if any part of the value transferred by the later transfer qualifies for the lower rate of tax in accordance with Schedule 1A.
- (2) The amount of the reduction made under section 141(1) is to be apportioned in accordance with this section.
- (3) For each qualifying component, the tax chargeable on so much of the value transferred by the later transfer as is attributable to property in that component (“the relevant part of the tax”) is to be reduced by the appropriate proportion of the amount calculated in accordance with section 141(3).
- (4) “The appropriate proportion” is a proportion equal to the proportion that –
 - (a) the relevant part of the tax, bears to
 - (b) the tax chargeable on the value transferred by the later transfer as a whole.
- (5) If components are treated under Schedule 1A as a single component, subsection (3) applies to the single component (and not to each of those components individually).
- (6) If, after making the reductions required by subsection (3), there remains any part of the tax chargeable on the value transferred by the later transfer that has not been reduced, the remaining part of the tax is to be reduced by so much of the amount calculated in accordance

with section 141(3) as has not been used up for the purposes of making the reductions required by subsection (3).

- (7) In this section –
- “component” means a component of the estate, as defined in paragraph 3 of Schedule 1A;
 - “the later transfer” has the meaning given in section 141(1);
 - “qualifying component” means a component for which the donated amount is at least 10% of the baseline amount, as determined in accordance with Schedule 1A.”

- 8 In Schedule 4 (maintenance funds for historic buildings etc), in paragraph 14, after sub-paragraph (2) insert –

“(2A) In determining for the purposes of sub-paragraph (2) the effective rate or rates at which tax would have been charged on the amount in accordance with section 7(1), the effect of Schedule 1A (if it would have applied) is to be disregarded.”

Instruments of variation to be notified to charities etc

- 9 In section 142 of IHTA 1984 (alteration of dispositions taking effect on death), after subsection (3) insert –

“(3A) Subsection (1) does not apply to a variation by virtue of which any property comprised in the estate immediately before the person’s death becomes property in relation to which section 23(1) applies unless it is shown that the appropriate person has been notified of the existence of the instrument of variation.

- (3B) For the purposes of subsection (3A) “the appropriate person” is –
- (a) the charity or registered club to which the property is given, or
 - (b) if the property is to be held on trust for charitable purposes or for the purposes of registered clubs, the trustees in question.”

Commencement

- 10 (1) The Schedule inserted by paragraph 1 has effect in cases where D’s death occurs on or after 6 April 2012 (and the amendments made by paragraphs 3 to 8 are to be read accordingly).
- (2) The amendment made by paragraph 9 has effect in cases where the person’s death occurs on or after 6 April 2012.

EXPLANATORY NOTE

INHERITANCE TAX: GIFTS TO CHARITIES ETC

SUMMARY

1. This clause and schedule provides for a lower rate of inheritance tax (IHT) of 36 per cent to be charged on a deceased person's estate where 10 per cent or more of the estate has been left to a charity or a registered community amateur sports club.
2. The change will take effect for deaths on or after 6 April 2012.

DETAILS OF THE SCHEDULE

3. Paragraph 1 of Schedule inserts a new Schedule 1A to Inheritance Tax Act 1984 (IHTA).

Details of the new Schedule 1A to IHTA

4. New paragraph 1 provides that the Schedule applies on the death of an individual where the net value of their estate (after deducting liabilities, reliefs and exemptions) exceeds the available nil-rate band. The excess value of the estate above the nil-rate band is subject to IHT at 40 per cent and is referred to in the Schedule as "TP". New Schedule 1A does not apply if the net value of the estate is below the available nil-rate band.
5. New paragraph 2 describes the relief.
 - New paragraph 2(1)(a) provides that a part of TP will qualify for the lower rate of IHT if it meets the charitable giving condition.
 - New paragraph 2(1)(b) provides that any remaining part of TP that does not qualify for the lower rate is to be taxed at 40 per cent.
 - New paragraph 2(2) provides that to meet the charitable giving condition, at least 10 per cent of the 'baseline amount' must be given to charity.
 - New paragraph 2(3) and (4) say where provision is made for the 'components', 'donated amount' and 'baseline amount' respectively.
 - New paragraph 2(5) provides that the part of TP that qualifies for the lower rate is all of the property in each of the 'components'

of the estate where the amount donated to charity is at least 10 per cent of the baseline amount for those components (the '10 per cent test').

- New paragraph 2(6) provides that the lower rate of tax is 36 per cent.
6. New paragraph 3 divides the estate into three parts or 'components' for the purposes of the new Schedule 1A: survivorship, settled property and general. New paragraphs 3(2) to (4) define the property that is included in each of the components.
- The survivorship component is made up of property which passes automatically to a surviving joint owner.
 - The settled property component consists of assets in certain trusts in which the deceased had a life interest or right to income immediately before their death.
 - The general component includes all other property that makes up a person's estate, including the free estate, which is not part of the survivorship or settled property components. This does not include gifts where the deceased continued to benefit from the property given away. Such property cannot qualify for the reduced rate.
7. New paragraph 4 provides that the 'donated amount' for a particular component or part of the estate is the total value of gifts to charities or registered community amateur sports clubs that are paid from that component and which qualify for exemption as gifts to charities or registered clubs under section 23(1) of IHTA.
8. New paragraph 5 provides for the calculation of the 'baseline amount' and sets out three steps to the calculation. The first is to arrive at the value transferred by the chargeable transfer, which is the gross value of assets in the component after deducting liabilities, reliefs and exemptions. The second step is to deduct the proportion of the available nil-rate band that is attributable to the component. The available nil-rate band is the amount left after allowing for any increase that arises from the transfer of unused nil-rate band under section 8A of IHTA and taking into account any chargeable transfers made during the seven years before death. The third step is to add back the value of gifts paid from that component which qualify for exemption as gifts to charities or registered clubs under section 23(1) of IHTA.
9. New paragraph 6 provides that the normal rules for establishing the taxable amount of the estate will apply in determining whether the 10 per cent test has been met with two specific exceptions.

- New paragraph 6(1) provides that for the purposes of calculating the donated amount and the baseline amount, any calculations under section 38(3) or (5) IHTA (grossing up) will be made using the lower rate.
 - New paragraph 6(2) provides that, for the purposes of calculating the donated amount (but not the baseline amount) any reduction in the donated amount that would normally arise through the interaction of exemptions and relief under section 39A IHTA is to be ignored.
10. New paragraph 7 provides for an election to merge two (or more) components of an estate where the donated amount from one (or more) component(s) is at least 10 per cent of the baseline amount for that component(s). If the combined components pass the 10 per cent test, new paragraph 7(3) provides that they are to be treated as a single component which will qualify for the lower rate. The election has to be made by all the “appropriate persons” specified in new paragraph 7(6), who may vary depending on the type of components being merged.
 11. New paragraph 8 provides for an election to opt out of the lower rate for one or more components of the estate so that they are treated in effect as if the charitable donation had failed the 10 per cent test. The election has to be made by all the same appropriate persons as specified in new paragraph 7(6).
 12. New paragraph 9 provides the procedure for making an election under Schedule 1A. An election must be made in writing within 2 years of the death and may be withdrawn in writing (by all those entitled to make the election) no later than 2 years and 1 month after the death. New paragraph 9(3) provides that both these time limits may be extended at the discretion of an Officer of Revenue and Customs.
 13. New paragraph 10 provides interpretation of specific terms used in Schedule 1A.

Consequential amendments

14. Paragraph 2 of the Schedule provides for consequential amendment to IHTA as a result of new Schedule 1A.
15. Paragraph 3 amends the cross reference in section 7 of IHTA (which specifies the rates of tax charged) to take into account the new Schedule 1A.
16. Paragraph 4 inserts a new subsection (2ZA) in section 33 of IHTA to provide that new Schedule 1A is disregarded when considering the

rate of tax to be applied to a charge under section 32 or 32A (where conditional exemption no longer applies). The effect of the amendment is that the lower rate of IHT would not apply to any deferred tax even if the 10 per cent test was satisfied originally.

17. Paragraph 5 correspondingly amends subsection (3) of section 78 of IHTA (conditionally exempt occasions involving settled property) by inserting a cross reference to the new subsection (2ZA) and subsection (2A) in section 33. The effect of the amendment is to ensure that new Schedule 1A is disregarded and the appropriate rate of tax is charged when the charge arises under section 78.
18. Paragraph 6 inserts a new subsection (2) in section 128 of IHTA which similarly provides that new Schedule 1A is disregarded when considering the rate of charge under section 128 (where woodlands relief no longer applies). The effect of the amendment is that the lower rate of tax would not apply to the deferred tax, even if the 10 per cent test was satisfied originally.
19. Paragraph 7 inserts a new section 141A of IHTA which specifies how the relief under section 141 of IHTA (relief for successive charges) should be applied where the later transfer, or part of it, qualifies for the lower rate of IHT.
 - Paragraph 7(1) provides that new section 141A applies where the later transfer, or part of it, qualifies for the lower rate.
 - Paragraph 7(2) provides that the relief is to be apportioned between the components of the estate as set out in new section 141A.
 - Paragraph 7(3) provides that where a component of the estate qualifies for the lower rate, the relief due under section 141(3) that is attributable to that component is to be calculated by reference to paragraph 7(4).
 - Paragraph 7(4) provides that the relief due to the estate as a whole must be divided between the components by reference to tax that is payable by each component (rather than by reference to the capital value of the components as would otherwise be the case).
 - Paragraph 7(5) provides for merged components to be treated as one component for the purposes of this calculation.
 - Paragraph 7(6) provides that any relief not applied against components that qualify for the lower rate is to be applied against components that do not qualify for the lower rate.

- Paragraph 7(7) provides interpretation.
20. Paragraph 8 inserts a new sub-paragraph (2A) in paragraph 14 of Schedule 4 of IHTA. The new sub-paragraph provides that, when the settlor is dead, new Schedule 1A is disregarded in calculating the “second rate” of tax to be applied to a charge under paragraph 8 of Schedule 4. (A paragraph 8 charge arises where the favourable IHT treatment of property, under a maintenance fund direction under paragraph 1 of Schedule 4, ceases to apply). The effect of the amendment is that the lower rate of IHT would not apply to any tax now chargeable even if the 10 per cent test was satisfied originally.
 21. Paragraph 9 inserts new subsections 142(3A) and (3B) into IHTA (alteration of dispositions taking effect on death). The effect of the amendment is that where property is redirected to a charity or registered club by means of an Instrument of Variation (IoV) the variation is not to be treated as being made by the deceased unless the persons executing the IoV show that the ‘appropriate person’ (charity, registered club or, if the property is held on trust, trustees) has been notified of the IoV. This applies whether or not the redirection is sufficient to qualify for the reduced rate.
 22. Paragraph 10 applies the new provisions in Schedule 1A and the consequential amendments to IHTA to deaths on or after 6 April 2012.

BACKGROUND NOTE

23. On death, inheritance tax (IHT) is charged on estates whose net taxable value (after deducting various reliefs and exemptions) is more than the IHT threshold, or nil-rate band. IHT is currently charged at a single rate of 40 per cent on the net taxable value of the estate above the available nil-rate band.
24. The value of an estate for IHT purposes can include not only the assets that the deceased owned immediately before death and is free to dispose of by will (the free estate), but also other assets and property such as interests in jointly owned assets which pass automatically by survivorship on death, interests in certain trusts, and assets given away but from which the deceased continued to benefit. The various categories of assets are combined to form an aggregate estate that is subject to IHT.
25. As an incentive to encourage charitable giving and support philanthropy, where 10 per cent or more of the deceased’s net estate (after deducting exemptions, reliefs and the available nil-rate band) has been left to charity, the taxable estate will be charged at a lower

rate of IHT of 36 per cent. The change will apply for deaths on or after 6 April 2012.

26. The total amount left to charity will be compared to the 10 per cent threshold or 'baseline' amount to see if the estate qualifies for the lower IHT rate. For the purposes of this '10 per cent test' the baseline will be the value of the estate charged to IHT after deducting all available reliefs, exemptions and nil-rate band but excluding the charitable legacy itself. If the estate qualifies, the lower rate will apply automatically but the personal representatives or other persons will be able to elect for the lower rate not to apply.
27. For estates which include additional assets to those that the deceased owned before death, the estate will be divided into up to three parts or 'components'. The 10 per cent test will be applied to each component separately and the lower rate will apply to those components that pass the test unless an election is made to opt out.
28. Where a charitable legacy from one or more components of the estate exceeds the 10 per cent minimum it will be possible, by election, to combine components and apply the 10 per cent test to the aggregate. Where the aggregate components meet the test, the lower rate will apply to the merged components. This will enable the benefit from charitable legacies of more than 10 per cent to be spread to other parts of the estate.
29. If you have any questions about this change, or comments on the legislation, please contact Danka Wigley on 020 7147 3674 (email: danka.wigley@hmrc.gsi.gov.uk).