How life policies can ease the probate problem

Synopsis: Life insurance can meet any potential inheritance tax liability on death and speed up the process of obtaining probate.

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For executors (or administrators where the deceased died intestate) to deal with assets in a deceased's estate, they will need to obtain a grant of probate (letters of administration where there is an intestacy). The term 'personal representatives' is used below to describe both executors and administrators.

Currently there can be delays of up to 12 months in obtaining probate on the estate of a deceased person). This makes it more difficult for personal representatives to access cash to meet inheritance tax. With a current interest rate of 7.75% payable on inheritance tax not paid within 6 months of death, this can become a very expensive process.

The average inheritance tax payable on an estate in 2020-21 was £214,000 and, if a liability of this amount is not paid within 6 months of the date of death, the estate would effectively be clocking up interest charges of £319 per week at the current rate of interest. A delay of 11 months from the 6 month payment deadline would give rise to an interest bill of more than £15,000.

Inheritance tax – the extent of the problem

Whilst less than 4% of estates are subject to inheritance tax, this number is starting to increase and is forecast to be over 7% by 2032-33. This increase is due in part to the rapid growth in wealth of older people and in part to the freezing of inheritance tax reliefs and allowances.

The nil rate band (NRB) has been frozen at £325,000 since 6 April 2009 and the residence nil rate band (RNRB) at £175,000 since 6 April 2020. They are due to stay at these levels until 6 April 2028. Had they increased in line with consumer price inflation (CPI), these allowances would now be worth, in total, more than £700,000.

Whilst the number of estates that are subject to inheritance tax is relatively small, when an estate is in the IHT net, this can result in a liability that can run into thousands of pounds.

People likely to be affected should therefore take action to reduce the impact of inheritance and implement mechanisms to enable cash to be available to meet the tax.

When is inheritance tax payable?

Inheritance tax is due 6 months after the date of an individual's death. HMRC will charge interest on unpaid tax at a rate that is 2.5% above the Bank of England base rate meaning the rate of interest is currently 7.75%.

This problem is compounded by the fact that the deceased's personal representatives need to raise the cash needed to meet an inheritance tax liability in order to get probate. This can be a practical problem especially where the estate comprises of property or shares in unlisted companies.

Before paying inheritance tax, the personal representatives should obtain an HMRC inheritance tax reference number by completing form IHT422. They should then submit the inheritance tax return IHT400 and pay the tax. Once the tax has been paid, HMRC will issue form IHT421 (Northern Ireland), receipted form C1 (Scotland) or a letter with a unique code (England and Wales) to the personal representatives in order for them to apply for the grant.

In very exceptional circumstances, the personal representatives may obtain a grant before paying tax if they can demonstrate it is impossible to raise the money to meet the inheritance tax before obtaining the grant. This is known as a "grant on credit". HMRC may place a charge on property to protect their position (IHTM05071).

Paying inheritance tax

Some help may be available by using the Direct Payment Scheme , which allows banks, building societies and National Savings & Investments (NS&I) to make direct payments to HMRC from the deceased's accounts to meet inheritance tax liabilities in order to allow probate to be granted. This system can be used by completing form IHT 423 (a separate form is required for each account).

Banks and financial institutions may be prepared to release funds to the deceased's personal representatives before probate (or administration) is granted. However, each institution will apply its own limits as to how much may be released so it may not be possible to raise the required amount using this route.

Personal representatives (especially those who are beneficiaries under the individual's estate) can also settle the estate's inheritance tax liabilities using their own resources (if available). The amounts paid can then be reclaimed from the deceased's estate or beneficiaries once probate (or administration) is granted. However, where serious probate delays exist this can give rise to apprehension over repayment and, in the meantime, the inability to use the funds.

Whilst specialist lenders may offer short term loans, interest rates charged may be high.

Advance Planning

Given the problems that personal representatives might have in raising cash to meet inheritance tax, it clearly makes sense for individuals to take action during their lifetime to make the position easier for their personal representatives and their beneficiaries to have easy access to cash on their death. This will enable them to meet the inheritance tax liability and so obtain probate.

In this respect the following actions could be considered:

- Cash held in a bank or building society account, could be placed into a joint account(s) with their intended personal representative or a close relative. On the individual's death, the legal ownership of the account passes to the personal representative or relative, although the beneficial ownership of the cash will normally remain with the deceased individual. The personal representative, as the surviving owner of the account, can then draw the funds down to meet the inheritance tax liability.

- Where shares and funds are held on a platform or under a nominee arrangement, it may be possible for the individual to give the platform provider or nominee advance authority to sell shares or funds ahead of probate to meet inheritance tax liabilities

Absolute Probate trusts

Another possible planning route is for the individual (the settlor) to establish an absolute probate trust, where the assets are held in trust absolutely for the settlor. Legal title to the trust assets vests in the trustees but the settlor is the sole beneficiary of the trust and can therefore access the benefits of the trust during their lifetime.

The assets held in the absolute probate trust remain part of the individual's estate for inheritance tax purposes (as they have the beneficial interest) but will not form part of the settlor's estate for probate (or administration) purposes. This means that the individual's personal representatives can access them after death to fund inheritance tax and other estate liabilities (such as funeral costs etc).

Indeed, if a life policy is held subject to such an absolute probate trust, a lump sum would become immediately available to the trustees which they could use to assist in meeting any inheritance tax liability and so speed up the process of obtaining probate.

How life assurance can help with inheritance tax

Effecting a life assurance policy which is then placed into a trust for the benefit of the deceased's estate beneficiaries can be a very effective route to provide sufficient funds to meet an inheritance tax liability.

The life assurance policy would typically be a whole of life policy either written on a single life basis or, where the individual's will provides that their assets will pass to their surviving spouse or civil partner, on a joint life last survivor (second death) basis.

As the policy is held in trust, it does not form part of the deceased's estate and is not subject to UK probate. On production of the death certificate, the trustees can claim the death benefits from the life assurance company and distribute these to the trust beneficiaries who will suffer because of the inheritance tax liability. Those beneficiaries can then lend the cash to the personal representatives to meet the inheritance tax liability.

Once the personal representatives have obtained probate, they can realise assets in the deceased's estate and repay the borrowing to the beneficiaries.

Paying inheritance tax in instalments

Where estate assets comprise of property, land or certain qualifying shares, personal representatives can apply to HMRC, via form IHT400, to pay the inheritance tax in instalments over a period of up to 10 years. The first instalment is due six months after the date of the individual's death.

Subsequent instalments will be subject to interest charges from HRMC (as will the first instalment if it is paid late).

The outstanding balance of the inheritance tax due can be repaid at any time but will become due immediately if the assets are sold.

Summary

The deceased's personal representatives will have many duties to perform after an individual's death. Trying to raise funds to meet an inheritance tax liability may be an additional burden and so it makes sense in a number of cases to effect a life policy in trust so that liquid funds that are not part of the deceased's estate can be quickly made available. This will help them to meet any potential inheritance tax liability on death and speed up the process of obtaining probate.

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