

IHT and transfers on death

Synopsis: Inheritance tax and property passing on death.

Date published: 20.06.2025

Estate on death

Inheritance tax (IHT) is charged on death as if the deceased had given away the whole of their estate (defined in s5 IHTA 1984) immediately before death - section 4 IHTA 1984. For these purposes a person's estate includes...

- Everything to which they are beneficially entitled;
- Settled property in which they have a beneficial interest in possession (i.e. a life interest that existed pre 22 March 2006 or an immediate post death interest (IPDI), a transitional serial interest (TSI) or a disabled person's interest (DPI));
- Any non-settled property over which they have an unrestricted power of disposal; and
- Property that is the subject matter of a gift with reservation of benefit in favour of the donor if that reservation exists at the donor's death.

"Property" is defined in section 272 IHTA and includes rights and interests of any description. There was a reminder of this in *Daffodil (Administrator of Daffodil Deceased) v IRC*. Mr and Mrs Daffodil owned a bungalow as tenants in common. The husband died intestate in 1994. As they were not joint tenants the deceased's share of the property did not pass to his widow automatically under the right of survivorship. Despite this, however, the widow was entitled to the whole of his estate but did not apply for a grant of letters of administration and continued to live in the bungalow. She died intestate in 2000.

Their son took out letters of administration on her estate (excluding his father's half share of the bungalow), which was valued at approximately £322,000 and IHT was paid. The son decided to sell the bungalow and in order to provide a valid legal title he applied for and was granted letters of administration to his father's estate.

HMRC issued a notice of determination which stated that his mother's interest in his father's unadministered estate formed part of her own estate for IHT purposes. The son appealed and contended that his father's share in the bungalow had not been transferred to his mother in her lifetime and she had not been entitled to it immediately before her death, so it did not form part of her estate.

The Special Commissioner dismissed the son's appeal. His mother had a statutory right to apply for a grant of letters of administration to her husband's estate. If another person applied for that grant, then she had the right to require that person to administer her husband's estate. She also had a statutory right to receive her husband's estate. Such a right was "property" and formed part of her estate for IHT purposes.

This case serves as a reminder that rights are valuable. The facts of the case were unusual, though, in as much as the married couple in this case owned the property as tenants in common and not joint tenants. Owning as tenants in common when married is usually (but of course not always) a preliminary step to IHT planning with a share in a property. Where a couple owns as joint tenants it is not possible for a joint owner to dispose of their share. Despite this inability to freely dispose, though, the share of a deceased joint tenant is not ignored for IHT.

In most cases this is of little (or no) consequence as the share of the first to die usually passes to the widow(er) and is exempt. Where the owners are not married/not in a civil partnership then a liability to tax could arise.

Changes to the deceased's estate which occur as a result of death, and which represent an addition to the property comprised in the estate, or an increase or decrease in the value of such property, are taken into account as if they had occurred prior to death (section 171 IHTA 1984).

Allowed deductions

Debts owed by the deceased are, of course, not part of estate for IHT purposes, provided they were taken out for genuine commercial reasons and not to avoid tax. To be deductible against the estate on death, debts must however not be derived from property that was owned by the deceased and must actually be repaid upon death. Debts will also be non-deductible to the extent that the amount owed has been invested by the deceased in property qualifying for relief from IHT or excluded property.

Excluded property is ignored in valuing a person's estate on death. The main categories of excluded property are..

- Property situated outside the UK that does not derive its value from [UK residential property](#) and which belongs to an individual who is not long-term UK resident.
- Reversionary interests, other than those acquired for money or money's worth, or those, for settlements made after 15 April 1976, where either the settlor, or the settlor's spouse/civil partner are beneficially entitled.

A deduction is allowed for reasonable funeral expenses (including the cost of a tombstone or gravestone) and for the deceased's debts that were incurred for consideration in money or money's worth, subject to certain exceptions.

Tax on death is calculated on the value of the estate at death plus the previous seven years' cumulation. The rate of tax on death is currently 40% (36% where 10% or more of the net estate (baseline amount) is left to charity) of the value of the estate in excess of the nil rate band (£325,000 until the end of the 2029/30 tax year) and, from 6 April 2017, any available residence nil rate band.

Gifts within seven years before death - falls in value

Relief is provided (under Section 131 IHTA 1984) if, at the time of the death of the donor within seven years of the gift, the value of the property given has fallen between the date of gift and the date of death or the date of a qualifying sale, if the property has been sold. Any tax due would, in such circumstances, be chargeable on a reduced value. Relief is available only if it is claimed by the person liable to pay the tax.

Example

Albert owns 51% of a property company X Ltd and gives 2% of the shares to Bill. The gift constitutes a 'potentially exempt transfer'. The loss to the estate, which reflects the loss of control of the company, is agreed at £100,000, which is substantially more than the value of the 2% minority holding itself. Within seven years of the gift Albert dies. Following a claim by Bill that the market value of a 2% holding has fallen from £10,000 at the date of gift to £5,000 at the date of death the value transferred is reduced from £100,000 to £95,000 for the purpose of calculating the tax on the gift.

Relief is available only where the property given still belongs to the donee or the donee's spouse/civil partner at the date of death, or where it has been sold to persons not connected with them in an arm's length transaction without any right to repurchase. If the asset transferred has been sold, the reduced value will be the market value at the date of sale.

The relief does not apply if the property given is movable plant or machinery or if it is tangible movable property with a predictable useful life of less than fifty years - for example, cars or most household goods – section 132 IHTA 1984.

Related property sold within three years after death

The value of property in the estate of a deceased person may be enhanced because it has to be valued with related property (section 176 IHTA 1984).

If the whole or part of the property in the estate is sold without the related property at a reduced value within three years after the death, the value of the property sold may be revalued at the death, without the related property.

Relief is given only if...

- A claim for the relief is made;
- The seller is the person to whom the property passed on death or the deceased's personal representative;
- The purchaser is unconnected with the seller;
- The sale is at arm's length; and
- There is no right to repurchase.

Falls in value of quoted securities

If the estate of a deceased person includes quoted securities and executors or other persons paying the tax on them sell any of them within twelve months of the death, they may claim that the total of the sale price (that is the gross price, before deduction of any expenses) should be substituted for the death value of the investments sold (section 179 IHTA 1984).

A revised value may also be included for quoted securities that are cancelled, or in which dealings are suspended, within twelve months after death. If a claim is made, all the securities sold within twelve months of the death of the deceased have to be revalued in this way. A claim cannot be confined to those securities that have fallen in value. So, the relief is available only if the executors or other persons paying the tax have sustained an overall loss.

The relief is restricted if any purchases of quoted securities take place in the period from the date of death to the end of two months after the last sale within the twelve months after death.

Example

Amber died on 1 August 2024. Her estate includes quoted securities worth £20,000. Within twelve months the personal representatives sell all the securities for £15,000. The 'loss on sale' is £5,000 and the value of these securities is reduced by £5,000. This means that tax is paid on £15,000.

The relief reduces the estate chargeable to tax and a refund is obtained.

The relief also applies to trustees of a will trust that has come to an end on the death of a life tenant. If the personal representatives or trustees then repurchase the securities within two months of sale, the loss relief would be withdrawn.

If, however, the beneficiary rather than the personal representatives, repurchases the securities immediately after the sale there is no loss of relief. This crystallises the IHT saving and allows the beneficiary to continue owning the securities, however, as the beneficiary acquires the securities at prices lower than their value at death it should be noted that the base value for capital gains tax purposes is lower as a result of this exercise.

It is also advisable before proceeding with this strategy to ensure that the tax saving is greater than the costs involved in effecting the transaction (e.g. dealing commissions, stamp duty and administration fees).

The investments that qualify for the relief are as follows...

- Shares and securities quoted at the date of death;
- Holdings in authorised unit trusts; and
- Shares in common investment funds.

Falls in value of land

If land, buildings or interests in land, forming part of a deceased person's estate, are sold by executors (or other persons paying the tax) within three years after the death of the deceased, they may claim that the sale price (if lower) should be substituted for the value at the death (sections 190 – 198 IHTA 1984). Where there is more than one sale, relief is limited to the net loss on all sales of land by the person or persons acting in a particular capacity.

A sale is disregarded if the price differs from the value on death by less than £1,000 or 5% of the value on death, whichever is lower. The relief for land is separate from the relief for quoted shares. A gain on one does not reduce a loss on the other.

For deaths occurring on or after 16 March 1990, the three-year period is generally extended to four years, a sale in year four being taken to have been made in the required three-year period.

The relief is not given on a sale to a beneficiary or one of their near relatives, and it is restricted if land is bought between death and the expiry of four months from the last sale within the three-year period. There are also rules that ensure that the date-of-death value and sale prices are compared on the same basis.

In a situation where the sale value is higher, a claim would reduce capital gains tax on the gain. This situation would be advantageous if there was no IHT on the estate - either because it was exempt or because it fell within the nil rate band.

Even if the estate is taxable, a claim to substitute a higher sale price will also be rejected on the basis that section 191 IHTA 1984 is only intended to provide relief from IHT. Therefore, regardless of whether the estate is taxable, HMRC will not allow a claim to substitute a higher sale value for land or buildings sold within three years of the date of death.

Quick succession relief

Relief is provided if a charge to tax arises on the death of a person who received property within five years of the death of another under an earlier chargeable transfer (section 141 IHTA 1984).

The tax payable on the death is reduced by a percentage of part of the tax payable on the earlier transfer. The percentage varies according to the period between the earlier transfer and death as follows...

- 100% if the period is one year or less;
- 80% if the period is between one and two years;
- 60% if the period is between two and three years;
- 40% if the period is between three and four years;

and

- 20% if the period is between four and five years.

The part of the tax on the earlier transfer to which the percentage is applied is the part attributable to the net value to the deceased of the property that became theirs as a result of the chargeable transfer. The relief is available whether or not the property on which the IHT was charged on the occasion of the earlier transfer was owned by the deceased at the date of death.

Example

Alex died in 2022/23 leaving their whole estate valued at £425,000, on which £40,000 IHT is paid, to Brenda. Brenda dies two and a half years later. The net value of the transfer to Brenda was £385,000 (£425,000 less £40,000 tax), so the tax qualifying for relief on Brenda's death is:

$$(385,000/425,000) \times £40,000 = £36,235$$

As Brenda died more than two years but not more than three years after Alex's death, £21,741 (60% of £36,000) is the relief to be set against the tax payable on Brenda's estate.

If the earlier occasion was a lifetime transfer and the donee dies before the donor, relief may still be available even though it cannot be determined whether any tax is in fact payable on the potentially exempt transfer (or further tax for a chargeable lifetime transfer) until seven years have elapsed from the date of the gift - unless the donor dies before the expiry of that period.

Provided the donee dies within five years of the gift, quick succession relief will be given on the donee's estate in the normal way once the amount of the tax on the gift is quantified.

The relief is also available for settled property. Where there are two successive charges and the second charge arises on the termination of an interest in possession, tax payable on the second charge is reduced by a percentage of part of the tax payable on the first occasion.

Variation of dispositions on death

A beneficiary entitled to any part of the deceased's own estate under their Will or intestacy or otherwise may alter its destination, within two years of the death, without incurring a charge to IHT by means of an instrument in writing. Such an instrument need not in the form of deed, but in practice a deed is normally used. When they do so, tax will be charged on the death as if the variation had been made by the deceased.

This means, for example, that property can sometimes be redirected away from the deceased's spouse/civil partner, so as to use the deceased's nil rate band (although this is of less importance following the introduction of the transferable nil rate band from 9 October 2007) or make a gift that is exempt (e.g. to a charity).

The same applies where, within two years of the death, a beneficiary makes a gift of inherited property after it has been paid or transferred to them, or disclaims a

legacy or other interest in an estate. The requirements for a valid instrument of variation are contained in section 142 IHTA 1984.

The Inheritance (Provision for Family and Dependants) Act 1975 and section 146 IHTA 1984

Under the Inheritance (Provision for Family and Dependants) Act 1975 and the Inheritance (Provision for Family and Dependants) (Northern Ireland) Order 1979, the Courts in England and Wales and in Northern Ireland may make an order in relation to any property forming part of an estate on death. Tax is then charged, and any exemptions or reliefs are given, as if the deceased had disposed of the property in the way ordered by the Court.

This is also the position where an order, commonly known as a 'Consent Order', is made giving effect to the parties' compromise or out of court settlement – section 146(8) IHTA 1984.

There is no charge to tax where, under an order of the Court, an interest in possession in settled property is brought to an end or property ceases to be held on discretionary trusts – section 146(6) IHTA 1984.

Scotland: legitim

In Scotland a surviving spouse/civil partner and dependants are entitled to claim a fixed share of the deceased's movable estate known as legal rights (section 147 IHTA 1984). This is regardless of any will provision. The child's share is known as legitim. These have to be claimed within 20 years or may be renounced in favour of the provisions set out in the deceased's will. If the estate is insufficient to meet a claim of legitim on the basis of an intended testamentary gift to the spouse/civil partner, the executors of the testator may choose whether tax should be charged on the basis that any disposition to the spouse/civil partner is fully paid out or reduced by any legitim not renounced.

Death on active service

The estate of a member of the armed forces of the Crown is exempt from the tax normally charged on death if they die as a result of a wound inflicted, or an accident occurring, or a disease contracted, when on active service or other service of a warlike nature. The exemption also applies if the member of the armed forces dies of a disease contracted at some previous time, the death being due to or hastened by the aggravation of the disease whilst on active service or other service of a warlike nature.

Certain other individuals also qualify for the exemption if they are subject to the law governing the armed forces or are members of certain ancillary organisations when the wound was sustained. To claim relief, the personal representatives of the deceased person must obtain from the Ministry of Defence a certificate to the effect that the conditions attaching to the exemption were satisfied – section 154 IHTA 1984. Similar relief is available for the estates of members of the Royal Ulster

Constabulary who die from injuries caused in Northern Ireland by terrorist activity - Extra-Statutory Concession F5.

For deaths occurring on or after 19 March 2014, the exemption for death on active service is extended to the emergency services (this includes firefighters, ambulance crews, coastguards and the police) and humanitarian aid workers responding to emergency circumstances. As with the death on active service exemption, the extension will also apply to emergency services personnel who die at a later date, as a result of an injury sustained responding to emergency circumstances.

The exemption for medals and other decorations awarded for valour or gallantry has also been extended for transfers of value made or treated as made on or after 3 December 2014 to cover all decorations and medals awarded to the armed services or emergency services personnel and to awards made by the Crown for achievements and service in public life.

Simultaneous deaths

Where it cannot be known which of two or more persons who have died survived the other or others they are assumed to have died at the same instant – section 4(2) IHTA 1984 and section 54(4) IHTA 1984. This prevents the double charge to tax that could arise from the legal presumption that the younger person survived the elder.

Example

Husband aged 60 who has an estate worth £400,000. His wife aged 50 has an estate worth £325,000. Under their respective Wills, each spouse leaves their entire estate to the surviving spouse, with a survivorship clause of 30 days. On the death of the surviving spouse the estate devolves on their children. Both spouses are killed in a plane crash in August 2023 and it cannot be established who died first.

For IHT purposes, it will be assumed that both spouses died simultaneously. The survivorship clause means that each spouse's estate would devolve directly on the children. No IHT would be payable on the wife's estate as it would be covered by the nil rate band of £325,000. The husband's estate would suffer tax of £30,000 as it exceeded the nil rate band by £75,000.

However, if the survivorship clause excluded the happening of simultaneous death, the husband's estate would, by the Law of Property Act 1925 (section 184), pass to the wife, as she is the younger. For IHT this is an exempt transfer. Also, for IHT they are deemed to die simultaneously, so immediately before her death the wife's estate is only worth £325,000. Therefore, the wife's estate is within the nil rate band and the husband's estate passes through the wife's to the children IHT-free (no matter what its size).

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