Death and the estate

OMB Personal tax

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Lisa Spearman looks at some key income tax and capital gains tax issues to be considered on death and in dealing with the estate

Key Points

What is the issue?

There are some particular processes for income tax and capital gains tax, and some specific rules applying, when an individual dies and for the estate.

What does it mean for me?

Executors may want to establish the annual tax position at an early stage to reflect in the inheritance tax return but estimates may be required. Income tax and capital gains tax payments falling due after the date of death are automatically deferred until 30 days after the grant of probate (or equivalents).

What can I take away?

There is a great deal to think about and it is wise to take specialist advice if there is any aspect of which you are unsure.

There are some particular processes for income tax and capital gains tax, and some specific rules applying, when an individual dies and for the estate. There is a very great deal to talk about so this article selects highlights only.

Timings and bureaucracy

It would be extreme tax planning to think that anyone could or would choose to time their death, but the actual date can make a difference. While – for the moment at least – we have a 5 April year end, a death immediately before that date is quite convenient. During the early days of April, it can be possible to simply include the details in the previous tax year for the purposes of reporting, etc. with an appropriate white space note. As the time goes on, deaths occurring in late summer and autumn can mean there is a practical delay in the ability to file a tax return electronically. You may wish to approach HMRC to get a return issued early.

Executors may want to establish the annual tax position at an early stage to reflect in the inheritance tax return but estimates may be required. Income tax and capital gains tax payments falling due after the date of death are automatically deferred until 30 days after the grant of probate (or equivalents); however, HMRC systems may not recognise that and it is wise to keep on top of demands for payment to prevent escalation of debt collection procedures. When preparing the penultimate tax return, the payments on account position for the final year of life may need to be reduced.

Before you can do any of these things, be aware that the 64-8 authority and engagement letter both end at the date of death. Executors will need to be asked to sign new documents as soon as possible to reinstate the ability to correspond with HMRC and see the taxpayer records.
Income tax on death

It is wise to look at each source on the last completed tax return to identify any particular points to watch. Dividends and bank interest are straightforward, as employment and pension income are likely to be. (There may also be adjustments to the final pension receipts to factor in.)

Where the deceased was self employed or in a partnership, things are a little more complicated. You will need to consider the cessation rules, post-cessation receipts and capital allowances rules, as well as any issues arising from VAT. Specific rules apply to stock valuations and there are a range of elections to consider. Income which has previously been relieved through a spreading rule or on an averaged basis may need recomputing. Finally, the inappropriately named terminal loss relief rules should not be overlooked. The deadlines for the elections need to be reviewed at an early stage and a review calendar maintained to ensure that nothing is missed.

Unforeseen income tax charges can arise on other items. For example, did the deceased hold any deep discounted securities? Deep discounted securities are treated as passing to the executors at market value and any ‘profit’ arising as a result is chargeable to income tax as if it had arisen immediately prior to the death. Perhaps oddly, death is not an occasion of charge for the accrued income scheme.

A common sight in the office is a chargeable event certificate from the insurers on the pay out of an investment bond policy. If the policy was in the sole name of the now deceased person, then there is an income tax charge. Where top slicing relief is in point on this, then the case of Marina Silver v HMRC [2019] UKFTT 263 and the resulting changes to HMRC policy needs to be reviewed.

Space does not permit a detailed consideration but suffice to note that specific rules apply for the year of death under the statutory residence test. If there is any question as to the residence of the deceased, this should be reviewed in depth.

Capital gains tax on death

As is well known, the assets held at death are rebased to their probate value and the accrued capital gain is therefore extinguished. A full annual exemption is applied to any gains arising in the hands of the deceased prior to the date of death but any unused amount is wasted. Losses of the year of death are not available to relieve any gains of the executors but can be carried back three tax years. Note that the loss carried back cannot be offset against gains attributed from an offshore trust.

Gains which have been deferred in lifetime using roll over reliefs reducing the base cost of the new asset are extinguished by the uplift at death. Note that the uplift applies only to those assets of which the deceased was competent to dispose. Certain gifts to take effect in the event of death but outside the will are not subject to the uplift.

It should be noted that executors are not able to make a negligible value claim on behalf of the deceased even if an asset became of negligible value in the tax year before death. Relief is given effectively by the absence of inheritance tax.

Income tax in estate

For the post-death income which arises during the administration period, the executors are the taxable persons; however, it should be noted that they are not ‘individuals’ and as such, for example, there is no personal allowance or savings rate available. The remittance basis is not available to personal representatives and the taxation of international estates and residence of personal representatives is a subject in itself.

Income of the estate does not include income to which the legatee is immediately and absolutely entitled from the date of death. Care needs to be taken to distinguish receipts from a trade which are post cessation receipts of the deceased from income arising from a trade carried on by the executors.

ISA tax free status has recently been extended so that it applies until the completion of the administration of the estate or the third anniversary of the death. A tax return should be completed for each year of the administration period.

Completion of administration period This can be a difficult date to identify.

It is defined as the date on which all steps have been taken to complete the administration. HMRC manuals say that they will usually accept the date provided by the executors; and practically this is often the date of the inheritance tax clearance certificate or – if close – the next 5 April. The date is also significant as being the commencement for any will trust.

Estate distributions

Where executors make distributions to heirs during the administration period, they must issue a certificate R185. This will include distributions of income, as well as distributions of capital if there is unallocated income received.

The final distributions and R185s are issued after the completion of the administration when all the relevant figures are available. Where Deeds of Variation (Family Arrangement) are entered into, a revision of entitlements may be needed.

Capital gains tax in estate

Due to the uplift to probate value, there may be limited capital gain in the estate. However, where the administration period is extended or there are high growth items, then gains should not be overlooked.

Executors may decide to appoint an asset to a beneficiary in satisfaction of a bequest as that is not a disposal for capital gains tax purposes. The legatee acquires the asset at probate value and may then use their own reliefs and allowances to mitigate any gain.

If there is a gain in the estate, the annual exempt amount for the tax year of death and the next two years applies while main residence relief is restricted.

Where assets are sold at a loss within 12 months of death, executors should consider whether a claim to adjust the probate value is more beneficial to the estate as a whole.

The requirement to report a sale of real property within 30 days applies equally to executors but the process is not easy. HMRC rather blithely suggests that the executor's own property account is used. Paper returns might be better.

Past errors correction

The review of the deceased's affairs caused by the death can often reveal past errors and omissions in their tax compliance. HMRC has three years from 31 January following the year of death to assess any unpaid taxes. This increases to six years if the failure is careless or deliberate.

Informal procedures

Tax may arise at the date of death or for the estate of a person who has previously simple affairs. In this case, the tax may be brought up to date in a single declaration under the informal procedures rules so long as:

- the probate value is under £2.5 million;
- the proceeds of assets sold from the estate are under £500,000; and
- a formal self assessment tax return has not been issued.

Conclusion

There is a great deal to think about and it is wise to take specialist advice if there is any aspect of which you are unsure.