These notes refer to the Finance Act 2012 (c.14) which received Royal Assent on 17 July 2012

FINANCE ACT 2012

EXPLANATORY NOTES

INTRODUCTION

Section 209Schedule 33: Gifts to Charities Etc

Summary

1. Section 209 and Schedule 33 provide 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 net estate has been left to a charity or a registered community amateur sports club. The change will take effect for deaths on or after 6 April 2012.

Details of the Schedule

2. Paragraph 1 of Schedule 2 inserts a new Schedule 1A to Inheritance Tax Act 1984 (IHTA).

Details of the new Schedule 1A to IHTA

3. 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.

4. 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'.
- 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.

5. 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 and which are treated as part of the deceased's estate.
- 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 property subject to a reservation (where the deceased continued to benefit from the property given away) which is treated as part of the deceased's estate. Such property can only qualify for the reduced rate if an election is made to merge it with one of these three components.

6. 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 value of a specific gift to charity 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) parts of an estate where the donated amount from one component is at least 10 per cent of the baseline amount for that component. If the qualifying component and one or more eligible parts of the estate pass the 10 per cent test when combined, new paragraph 7(3) provides that they are to be treated as a single component which will qualify for the lower rate. The eligible parts of the estate for such a merger include the other components and property subject to a reservation which is treated as part of the deceased's estate. The election has to be made by all the "appropriate persons" specified in new paragraph 7(7), who may vary depending on the parts of the estate 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(7).

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.

- New subsection 141A(1) provides that the section applies where the later transfer, or part of it, qualifies for the lower rate.
- New subsection 141A(2) provides that the relief is to be apportioned between the components of the estate as set out in the section.
- New subsection 141A(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 new subsection (4).
- New subsection 141A(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).
- New subsection 141A(5) provides for merged components to be treated as one component for the purposes of this calculation.
- New subsection 141A(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.
- New subsection 141A(7) provides interpretation.

20. Paragraph 8 inserts a new paragraph 14(2A) into Schedule 4 to 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 for any part of the estate 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.