



Inheritance Tax – Leaving 10% of an estate to charity

Inheritance Tax (IHT) is payable on a person's net estate at a rate of 40% after the deduction of the nil rate band (currently £325,000) and any other exemptions and reliefs.

If, however, a person (the testator) leaves 10% or more of their net estate to a registered charity, the rate of inheritance tax can be reduced to 36%. This reduced rate applies to the estates of testators who die on or after 6 April 2012.

There are a number of ways in which a testator can leave a charitable legacy in their Will, for example by way of an outright legacy or by using a trust.

Considerations for leaving a Charitable Legacy

- If there are non-charitable beneficiaries in the Will, as well as charitable beneficiaries, the non-charitable beneficiaries, will receive less than if no charitable legacy were made, but they will benefit from the reduced IHT rate.
- The larger the gift to charity, the greater the overall IHT saving will be.
- The size of the legacy required to qualify depends on factors which may vary between the execution of the Will and the date of death, such as:
 - a) the size of the estate;
 - b) the availability of the nil rate band and any additional nil rate band transferred from a spouse or civil partner; and
 - c) the availability of exemptions and reliefs.

How to make an effective Charitable Legacy

Percentage Legacy

Generally speaking, wording can be incorporated into a Will specifying that a percentage of the estate which qualifies for this reduced rate of IHT is left to a registered charity.

By using this option the testator can make certain provisions (such as a maximum or minimum amount), but the disadvantage is that the actual size of the legacy is uncertain.

Discretionary Trust

If a testator does not want to leave any more than is necessary to benefit from the reduced rate of IHT, the testator may wish to use a discretionary trust.

The discretionary trust could include charities as discretionary beneficiaries or have power for the trustees to add charities as discretionary beneficiaries. A letter of wishes could request that the trustees give a legacy sufficient to meet the 10% requirement within two years of their death so that the lower rate of IHT can apply.

Specified Amount

If neither of the above options are suitable, a testator can leave a charitable legacy that they expect to meet the 10% test by specifying the amount of the legacy.

There is however the risk that the charitable legacy will not be enough for the reduced IHT rate to apply, or that it is much more than 10% of the estate.

If the main priority is to benefit charities, then this could be the most appropriate and simplest option.

The Calculation and the Three Components

Although the concept of leaving 10% of an estate to charity is simple, the actual calculation to establish whether the reduced IHT rate can be applied is complicated. As well as assets owned outright any jointly owned and assets held in certain types of trust need to be brought into the calculation.

Exemptions should then be deducted (e.g. the spouse exemption) along with any liabilities and reliefs. From that figure, the available nil rate band should be deducted. Usually, 40% IHT is payable on this amount.

To establish whether the estate qualifies for the reduced IHT rate, add back in the value of the assets that qualify for the charity exemption to find your 'baseline figure', that is 10% of the estate including the charity exemption.

A worked example

T has an estate of £800,000 with all assets owned outright and leaves £70,000 to charity. T has liabilities of £5,000 but no other available reliefs or exemptions, (save for the charitable exemption of £70,000) which should be deducted from the value of the estate. This leaves a figure of £725,000.

T has his full available nil rate band which must also be deducted from the value of T's estate to give £400,000. The charitable gift should then be added back in to give the 'baseline figure' of £470,000.

T's gift to charity is more than 10% of the baseline figure (£47,000) and so the IHT reduced rate of 36% can be applied.

The IHT payable is £144,000 instead of £188,000 if the gift were not made to charity; a saving of £44,000.

Non-Domiciled UK Individuals

For non-domiciled (or deemed domiciled) UK individuals, the baseline amount is limited to assets on which the individual is liable to IHT. In general this will only be UK assets.

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