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Death takes centre stage

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KEY POINTS

- Deteriorating public finances and an ageing population bring estate taxes to the fore.
- Government proposals for a 10% tax charge on death.
- Local authority proposals to defer council tax until death.
- Possible problems with valuations.
- Will there be more insolvent estates?

Inheritance tax has taken on an increasingly high profile in the run-up to the general election.

Politicians have made promises in the good times which they are having second thoughts about when faced with a sudden deterioration in public finances and the consequences of an ageing population.

From being a relative backwater in popular discussions on taxation, inheritance tax (or 'death tax' as the media now calls it) is now taking centre stage.

Naturally enough, the debate on inheritance tax focuses on the financial winners and losers.

However, in addition to identifying who those winners and losers are, it is important to consider some of the practical and administrative issues raised by the various tax proposals, as these also have a significant impact.

Government proposals

There have been two different proposals for changes to the tax regime relating to a deceased person's estate. The first is very conventional and was proposed by the Health Secretary, Andy Burnham, in a speech on 10 March 2010.

The key element of this is that there would be a 10% levy on estates to pay for social care.

Crucially, there would be a no nil-rate band and thus many more estates would be subject to taxation based on the value of assets and liabilities.

This would inevitably mean that the complexity, and thus the cost, of administering small value estates would increase.

The key point is that the valuation of an estate is not a trivial process. The amount of tax payable is not based on a determinate cash amount, but rather on an estimate of the worth of assets and liabilities.

The problem is particularly acute when it comes to property where valuations will always have a subjective element. If the assets are overvalued, too much tax is paid and the beneficiaries lose out. If it is undervalued then the tax authorities lose out – and they have the power to levy fines if such an undervaluation is discovered.

Getting a valuation which is fair to both sides costs money (which has to come from the estate) and it requires the deceased's family to get involved in some tricky tax issues.

It is true that, currently, all estates have to be valued to determine whether inheritance tax should be paid.

However, the degree of precision needed to value taxable estates is greater than that for non-taxable estates. If the proposals outlined in Andy Burnham's speech are implemented, then there will be many more estates incurring higher administrative costs as a consequence of the new tax.

Local authority proposals

The second proposed change in tax on estates was reported in *The Daily Telegraph* on 21 February 2010: 'Pensioners face pay as you die council tax, Tories claim'.

Under this proposal, council tax bills would be deferred and paid out of an individual's estate after death. If this were to be introduced it could, in theory, be mimicked by other organisations that need to charge elderly people, but balk at the difficulties of enforcing collection of the debts.

It is important to realise that this arrangement is not a 'death tax' – a tax is only payable if there is something to tax. Rather it is more like a loan from the local authority to the individual and is presumably repayable regardless of the wealth in the estate.

This distinction is not just of interest to accountants; in practical terms it is likely to mean that estates of the deceased will have higher levels of liabilities than they would otherwise have.

The greatest concern is the impact this might have on more modest estates. If there is an increase in the aggregate liabilities borne by estates then this is likely to lead to an increase in the number of insolvent estates. Solicitors and professional probate specialists will always avoid working on behalf of an insolvent estate.

This is not just because they may not be reimbursed for their efforts; by law, creditors should take the lead in winding up an insolvent estate. The processes for this are long-winded and much more cumbersome than for solvent estates.

There will be more bereaved people finding that they cannot get help in winding up an estate since professional advisers will not wish to take on their case for fear that the estate may be insolvent. We could be in a position where those most in need of a professional service are least able to get it.

Conclusion

Tax changes will always generate interest from those who benefit or lose financially. It is almost as important to focus on the administrative consequences of any change since they can have a large impact on people who are at a very vulnerable stage in their lives.

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