CIOT meets OTS to discuss its Inheritance Tax Review Call for Evidence and Survey

Inheritance Tax and trusts

01 September 2018

On 27 April 2018 the OTS announced its review of inheritance tax (IHT), to explore simplification opportunities across the existing legislative framework and the administrative processes through which taxpayers interact with HMRC. CIOT has met with the OTS to feed in its views.

Rather than submitting a written response to the OTS' Inheritance Tax Review Call for Evidence or respond specifically to the Survey, representatives from the CIOT's Succession Taxes Sub-Committee took the opportunity to meet with the OTS to discuss the various issues raised in the Call for Evidence and the questions posed. This enabled us to have a wide ranging discussion with the OTS and directed our efforts more constructively to provide more detailed and practical input than would have been possible in written form.

Below we summarise our discussions.

Simplifying the existing legislative framework

In our view, the key principle in any reform should be to remove complexity, as you cannot add simplicity. That said, it was noted that, although the scoping document referred to 'the perception of the complexity of the IHT rules', to professionals working in the field IHT the legislation is at least clear and relatively stable. The complexities associated with IHT are mainly the result of later 'bolt on' changes such as pre-owned asset tax and the residence nil rate band (RNRB).

In brief, specific areas discussed which could be made simpler included:

- increase the annual exemption (£10,000 was mentioned) – to be indexed to a rounded figure or linked, for example to the income tax personal allowance or capital gains tax annual exemption. This could be in return for abolishing the carry forward of unused annual exemption and the marriage exemptions.
- Small gifts play a valuable role in covering birthday and Christmas gifts. We suggested that these should be kept as to leave these to be covered by an increased annual exemption would mean a lot more record keeping and attention required by taxpayers which would not be simplification. We suggested raising the small gifts exemption to a more realistic figure (£500 was mentioned).
- In our view, the normal expenditure out of income exemption must be retained as matter of principle (IHT taxes transfers of capital), and any restriction or cap would not (we believe) be a simplification.
- To remove the RNRB and introduce a cash allowance would be a huge simplification. However, recognising the political drive behind RNRB, we accepted that radical change would be difficult. The complexity comes from the design of the relief which requires (i) ownership of a specific type of asset (dwelling) and (ii) a certain category of recipient (close inheritor). Nevertheless, possible RNRB changes included:
    - Children of unmarried partners qualifying as ‘closely inheriting’ if treated as a ‘child of the family’, a well-established legal concept. However this change would only benefit dependent children. A wider definition would be needed to cover an unmarried partner’s adult children. The difficulty in achieving ‘fairness’ here points back to the simplicity of a straight cash allowance as an alternative.
    - Change the treatment of a split residuary estate – where only part of the residue is closely inherited, HMRC maintain that only a corresponding proportion of the dwelling qualifies for RNRB. This causes unnecessary problems where the deceased made provision for a charity or a non-descendant, for example a sibling, who lives in the family home, where sufficient value overall is closely inherited but relief is denied if HMRC’s current approach is taken. We suggest that the rules should be amended to at least allow assets to be appropriated to the beneficiaries who ‘closely inherit’ in order to satisfy the requirements.
    - Allow RNRB in cases where there is (technically) a relevant property trust, for example ‘to grandchildren at a contingent age such as 18 or 25’ and no ‘immediate post death interest’ exists. The present disallowance of RNRB

in such circumstances runs counter to what would be prudent, ‘real world’ practicalities.

- Reversing IHTA 1984 section 114 so that Business Property Relief (BPR) takes precedence over Agricultural Property Relief (APR), would avoid the need to clear APR first, with all the complications of agricultural value; this would leave a claim for APR and the requirement to determine agricultural value in only rare cases that have not fallen within BPR.
- BPR: the limited 50% relief for land, buildings, machinery or plant used in a business causes problems. First, the 50% relief is itself anomalous – why not 100% for all categories of business property? Second, the need for control of a company that uses such assets can cause unfairness. We suggested that, given that the purpose of the relief is to encourage business, the objective could be met (while not allowing passive ownership) by reducing the threshold for relief to that of a ‘significant holding’ of, say, 20%.
- We suggested an abolition of 50% relief on Agricultural Holdings Act lettings so that 100% APR is available for all types of let farmland. In our view the current 50% relief is anachronous, creates a trap for the unwary, and can be avoided by expensive and detailed planning. Such manoeuvring should not be necessary.

Simplifying administrative processes

We raised two main concerns over process.

First, any ‘simplification’ of IHT must not come at the expense of the right people inheriting as they are entitled to under the deceased person’s will or the laws of intestacy. Some banks pay out balances on accounts to ‘next of kin’, without requiring grants of probate, sometimes alarmingly by-passing the proper beneficiaries. Whilst this practice was originally just for small balances under £5,000, our understanding is that the practice has expanded.

Second, asset protection trusts, and trusts to avoid probate fees, have proliferated. The significance of the probate process as a means of collecting IHT, with the IHT 400 completed before probate is granted, should caution the Ministry of Justice against re-introducing the proposed higher probate fees suggested in 2017. It is likely that such a step would lead to a huge growth in probate avoidance trusts by will writers, to circumvent the need for probate to secure title to assets. The result is potentially a significant loss of IHT for HMRC.

Other comments

Our other suggestions for simplification included:

- A simpler process where no tax is payable due to the nil rate band (NRB) or transferable nil rate band (TNRB) to avoid the need for a full IHT400, would be useful; for example in circumstances where part of a NRB has been used on the death of the first spouse so a reduced TNRB applies on second death.
- The secondary liability of personal representatives to pay tax on ‘failed’ potentially exempt transfers due to death within seven years of the gift is harsh. A statutory right of recovery from the beneficiary would assist. Currently there are problems for personal representatives who discover lifetime gifts late in the day, despite making reasonable enquiries – sometimes because family mislead them (consciously or not) – and who have distributed assets and then have a personal liability.
- Presentation of assets at 10-year anniversaries for relevant property trusts. Where there is undistributed income (from within the past five years) HMRC often expect the assets of the trust to be separated into those which represent the trust capital and those which represent the income. Trustees do not normally prepare accounts which split their balance sheets between the income and capital, and need to make what can be quite an arbitrary split of the assets between income and capital purely to accommodate HMRC’s demands: it would be simpler if HMRC could be satisfied that the amount of the undistributed income can simply be deducted from the general working capital.