

**Office of Tax Simplification
Inheritance Tax Review – Call for evidence**

June 2018

Summary

We submit within this paper our responses to the Inheritance Tax (IHT) Review – call for evidence questions **only**, raised within the OTS' document 'Inheritance Tax Review – Call for evidence', issued April 2018.

Johnston Carmichael LLP is the largest independent accountancy firm in Scotland. We act for over 12,500 individual clients across the UK and approximately 200 Trust clients. We also act for over 2,000 clients in the farming sector. Within the services we provide as a firm, private client tax work and inheritance tax work makes up a significant amount of the work that we do.

The call for evidence appears to focus predominantly on the administering of estates on death, yet much administration for IHT is required in lifetime, for example when an individual transfers an asset into a relevant property trust, crystallising a chargeable lifetime transfer.

A) Response to IHT questions

Payment and forms

- 1. If you have completed an IHT form, please state which form(s) you completed and whether you completed them in your professional or individual capacity. Please describe any problems you had in navigating the form(s) and provide any suggestions you have on how the forms or related guidance could usefully be simplified, made clearer or made easier to complete.**

Whilst we complete in a professional capacity forms IHT400, recording the estate on death, we carry out much more work in respect of completing forms IHT100 (required when certain lifetime transfers are made).

Our experience of both forms is that they are not user friendly, multiple supplementary forms require to be submitted and there is no easy link through online. It is often a struggle to even save the data that has been input into the form.

Furthermore, the forms are constrained in that often they do not cover the circumstances of the case and the guidance is insufficient to point to a way forward.

In our opinion the forms should be online only, with flexibility to complete, save and submit online. The forms should also be able to interact with each other. The forms should also be reviewed to consider are they asking the questions clearly, currently there is dubiety in certain instances when determining what category to place your entry in.

Finally, there is currently no acknowledgement system, it is not uncommon for a year/years to pass before HMRC even acknowledge receipt of the form, particularly with IHT 100's. This leaves the client in limbo.

- 2. In general, the deadline for payment of IHT is 6 months after death, whilst the deadline for submitting the relevant IHT form is 12 months after death. Please describe any problems or issues that arise because of this.**

The deadline of 6 months for payment of the tax is not sufficient time in our opinion, given the work involved in dealing with an estate and when dealing with lifetime transfers and/or transfers into Trust. Often the situations being reported on are extremely complex and it takes significantly more time than 6 months to reach a grounding as to the IHT payable.

In our opinion the deadline should be 12 months for completion and 12 months for payment of the tax.

When completing the form IHT100 – only six months is given for payment of tax and submission and this is too tight a timeframe for practitioners to adhere to. Timelines should be extended and aligned with the IHT400.

Probate

- 3) Does this process create practical difficulties? Bearing in mind the benefit of this mechanism, what could be done to address any such difficulties? To what extent does the instalment payment option where the IHT is attributable to certain assets in instalments help mitigate any issues?**

We have not commented on this question as the administering of the assets will be carried out by the lawyers and they will therefore be best placed to comment on this from a professional perspective.

Estates that do not have to pay IHT

- 4) Are there any disproportionate administrative or compliance burdens in establishing whether the value of the estate is below the NRB, or where the spouse exemption applies? How could these be reduced?**

In our opinion the system is incredibly complex for the layman to navigate. For example, in Scotland there is a form of forced heirship, so you could have an estate in excess of the nil rate band but all assets left to the spouse, i.e. spouse exemption applying, so no IHT. However, the child of the deceased claims legal rights and they are entitled to an amount which exceeds the nil rate band and therefore an IHT liability is due and a requirement to accordingly report the position to HMRC.

Scots law and English law are incredibly different and often HMRC guidance is more focused on English law which could misguide UK taxpayers when considering their tax obligations.

- 5) Could the guidance on www.gov.uk be improved to support people handling estates on which no IHT will be paid? If so, how?**

Based on the guidance currently in place on HMRC's website, much work is required to make this more user friendly and interactive. Perhaps a form of ready reckoner, which we have for other taxes (i.e. LBTT), that lets you input assets, answer various questions and then tells you whether or not you need to call for assistance to HMRC/complete a return or not, would help the individual.

6) What, if anything, could be done to help executors administer an estate and fulfil their obligations?

Everyone's circumstances are unique; therefore, it is difficult to create a 'one size fits all' message. We know there are multiple interactions that can create a different result. For example, we not only have a nil rate band which many individuals do not understand, we also have a residence nil rate band. There is significant complexity to this new relief and it could have been dealt with in a much simpler fashion.

Administering an estate, record keeping and valuations

7) What, if anything, could be done to help executors administer an estate and fulfil their obligations?

As set out at question two above, the timeline for paying the tax could be extended to give executors the time to pull together the assets. Perhaps a toolkit – giving executors a step by step guide of how to go about administering an estate would also help.

8) Have you been required to obtain a valuation of assets for the purposes of completing an IHT form? Was there any difficulty in doing so? Was the cost of the valuation commensurate with any IHT payable? What could be done to simplify this process?

It is common to have to obtain a valuation of an asset, both for the death estate and in lifetime on transfers into and out of Trusts. Depending on the asset this can be costly and time consuming, for example the transfer of a large Highland Estate would involve numerous valuations being obtained and take significant time to obtain. Often, particularly when dealing with IHT 10 year anniversary charges or IHT exit charges the professional costs of obtaining the valuation and completing the returns, greatly outweighs the tax at stake.

Likewise, the time taken by HMRC's staff is likely to be more in cost terms than the funds received by the Exchequer. There is merit one would say in having a de-minimis amount for IHT in terms of tax at stake. If falling below the deminimis, i.e. £5,000 perhaps, no return is required.

(Questions 9, 10 & 11 – addressed together)

9) Are there any aspects of the interaction between the thresholds and exemptions relating to lifetime gifts that you find especially distortive or complex to understand and apply? Please provide examples.

- 10) How, if at all, should these rules be simplified? What could be done to improve public understanding of the rules? Have you found that the joint liability of the estate and the person receiving the gift can cause problems for executors or HMRC?**
- 11) How, if at all, could the monetary thresholds and the various lifetime exemptions be simplified?**

Numerous IHT reliefs have stayed static for years and are now a complexity in the system without adding any real benefit.

It is only fair if such reliefs exist that they be increased in line with CPI/RPI. For example, the annual exemption of £3,000 has been at this level since 1981. Gifts in consideration of marriage and small gifts exemption have also not increased.

The burden of tracking such small gifts is disproportionate to the tax saved.

Why not create one relief for annual exemption, small gifts exemption and gifts in consideration of marriage then the taxpayer could more clearly understand the position and the burden on the executors would be reduced.

Businesses

- 12) How, if at all, does the IHT framework, including the related tax considerations set out above, make business decisions challenging? For example, does it affect or distort decisions regarding:**
- a) whether to sell or transfer a family business to another vehicle or directly to the next generation during lifetime or wait until death,**
 - b) the structure of the business (for example, how to hold non-trading assets),**
 - c) the choice of business vehicle (for example a corporate entity, partnership, unincorporated business), or**
 - d) investment in unlisted trading companies (including those traded on the alternative investment market (AIM))?**

Undoubtedly IHT reliefs, such as business property relief (BPR) and agricultural property relief (APR) have an impact on succession particularly within the family business.

That said, in the most part 'genuine' trading businesses are not impeded from passing on the business as the 20% CGT tests, both for holdover and ER do not prevent a blocker to passing on the asset in lifetime. Often though, the indecision lies with the business owner and there is a deep bond there with regard to the owner/often founder of the business and the business. Also, the business is often the owner's pension

provision in effect and it is common for business owners to remain active in the business right up until death.

The 50% IHT test is more generous than the CGT tests, that said the test is such that excepted assets within a business are captured and precluded from IHT relief which is only fair.

Individuals must operate and adapt to the prevailing tax rules in place and therefore it is reasonable to assume that business owners will ensure they best manage their and their businesses' tax exposure in lifetime, it would be naive to think otherwise.

In summary, in terms of market distortions IHT reliefs play but a part in this and other personal reasons are often behind retaining the family business for example up until death. Asset protection tends to be a key driver for a business owner, there is a fear quite often that all the years of hard work will be lost if the business is handed over.

If IHT reliefs, such as APR and BPR were not available then the risk is that many family businesses would go to the wall as the funds would not be available to suffer what is in effect a dry tax charge. The repercussions of this for the economy would be significant, taking into account the staff these businesses employ and the important part they play in rural, town and city lives, together with the knock-on impact to the supplier base.

- 13) Do the different requirements for trading across BPR, CGT gift relief and entrepreneurs' relief cause complexity and, if so, how could this be addressed? Are there any other inconsistent definitions or approaches either within IHT, or across IHT and CGT and if so, does this cause complexity? Do you have any other suggestions as to how to remove complexity around the interaction between CGT and IHT?**

The UK tax legislation is incredibly complex, care must be taken in introducing change that added complexity is not the result. For example, with the residence nil rate band, various Trust consultations in recent years if anything have only made the position more complex.

- 14) The availability of BPR is not generally dependent on the size of a person's interest in a business or holding it for any period after death. Does this feature of BPR add to or reduce complexity?**

If anything, this reduces complexity, to start bringing in a threshold for when BPR applies, runs the risk of doing a dis-service to smaller business interests which is the life blood of the country. Likewise preventing people from passing/selling an asset post the owner's death would stifle market forces and would be 'tax wagging the tail'.

- 15) How, if at all, does the IHT framework, including related tax considerations set out above, make business decisions challenging? Does it affect or distort decisions regarding:**
a) whether and when to sell or transfer the farm to another vehicle or to the next generation, or downsize during one's lifetime, or wait until death,

b) the choice for farm owners of letting out farmland versus farming themselves or via a contract farming arrangement,

c) the inhabitants and use of the farmhouse,

d) the choice of business vehicle for the farm (for example a corporate entity, partnership, unincorporated business), or

e) the structure of the business (for example, how to diversify or hold non-trading assets)?

We have detailed our thinking in this area in question 13 above. Whilst IHT and other tax reliefs will have an impact on the decision-making process, often it is not the key driver. Wealth preservation, asset protection and more frequently than not – no obvious successor is what delays the passing on of the family farm.

With regard to selling the family farm to the next generation – you will note if reviewing UK statistics on farm income levels in the UK that the debt level is rising within farms and the ‘take home’ income is decreasing. Therefore, there would not be the available funds within the family or willingness from the bank in most instances to lend and so the farmer often has to retain the farm, remain actively farming it in order to provide an income in his twilight years.

In terms of letting farmland versus contract farming arrangements, for farms with only agricultural value and no development value then this is not going to be in point, it is only farms with development value that are likely to require BPR in order to mitigate IHT. The reality though is that even if the rules were changed such that BPR was available if you had farmed the land let’s say for 10 plus years actively and were now of an age (retirement age perhaps) whereby you couldn’t due to ill health continue to farm it but would not be penalised for letting it, you may find this would not create the intended swing of land coming onto the market for letting. There are various reasons for this, to include the uncertainty around Brexit and farming subsidies under the common agricultural policy being such that farmers for now do not wish to change their current operating structure until clarity is provided.

16) Could the criteria for being a farmhouse or the process of determining the agricultural value of the farmhouse be simplified? If so, how?

In terms of the farmhouse, again this area is more complex than it needs to be, in our opinion a farmer who has spent his/her life working on the farm and is now of an age they can no longer be active on the farm, should not find their home exposed to IHT. This creates a tax burden, where often there is not the funds to cover it.

17) What, if any, complexities arise from the fact that BPR and APR overlap, at least in part? Are there discrepancies in the way that they operate? Would it help if APR was replaced by BPR or if the two were merged?

Any changes to APR and BPR must be carefully considered. For example, if APR was abolished – the farmhouse would then come into charge and this could put farming businesses to the wall if a dry tax charge arose at death. Likewise no APR would see farmers cease to let land at all and farm it themselves and this is not necessarily the best economic outcome.

- 18) How well do you think the charitable exemption and the lower rate of tax on death is understood by advisers or the public? Please tell us about any areas of complexity in the application of this rate, or the charitable exemption, along with any suggested improvements.**

We do not believe the charity exemption is understood at all by the general public. As with many reliefs introduced it is too complex for the layman to understand.

- 19) Please tell us about any other areas of complexity in applying any IHT rules, reliefs or thresholds not already mentioned in your response, along with any suggested improvements. You may, for example, wish to comment on the residence nil rate band, the IHT treatment of trusts, the IHT treatment of personal pensions and life insurance products, or the conditional exemption for certain works of art or heritage assets.**

The residence nil rate band is far too complex for all it achieves, better to increase the nil rate band.

- 20) Do you think that the IHT system should be reformed more widely to simplify it? If so, how? Should some IHT exemptions be removed to fund a lower or graduated rate or a higher NRB? If so, which ones? Are there any useful lessons that could be learned from other countries? If so what, and from which countries?**

There are certain parts of the IHT code that could be made simpler, for example some of the small reliefs being rolled into one annual amount. An increase of the nil rate band and removal of the RNRB.

With respect to critical reliefs such as APR and BPR, these reliefs protect the passing on of family businesses, without which our UK family businesses would in a lot of cases cease to exist. As the UK government prepares itself to exit the EU, removing one or other of these reliefs would further disadvantage UK business in what is already going to be an extremely tough trading climate.