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# High hopes for the simplification of inheritance tax

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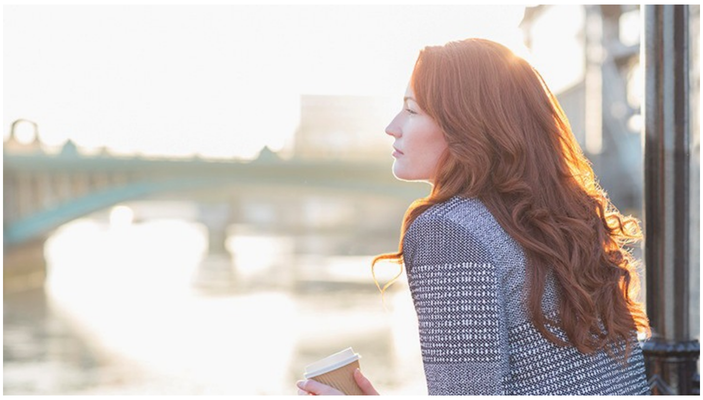

Despite the fact that inheritance tax (IHT) affects only 3.4% of UK estates, Chancellor Philip Hammond has the IHT regime in his sights.

At the end of January 2018, Mr Hammond wrote to the Office of Tax Simplification ( OTS) requesting a review of the IHT regime. In his letter the Chancellor asked the OTS to focus on:

• technical and administrative issues

• the practicalities associated with disclosure and routine planning techniques

• how current gift rules interact with the wider IHT system

• whether the current framework causes distortions to taxpayers' decisions surrounding transfers, investments and other relevant transactions

There is no doubt that piecemeal changes to the IHT regime since its introduction in 1986 have resulted in legislation that is often confusing and difficult for taxpayers to understand. Moreover, the most recent changes to the rules, brought in only last year, have had the effect of extending significantly the scope of IHT by treating a wider range of individuals as domiciled in the UK for IHT purposes, and by bringing within the charge to IHT ownership interests (and other interests such as loans) in non-UK companies and partnerships which derive their value from UK residential property.

A move to simplify and rationalise the IHT regime is therefore welcome for those affected by it. The risk, of course, is that the review may lead, instead, to a more complex and unfriendly IHT regime for the taxpayer.

The scope of the OTS's review is not yet known – but some of the areas that we think could be improved, or which we think the OTS is likely to focus upon, are outlined below.

**IHT on lifetime gifts and annual exemptions**

As well as the annual exemption (£3,000 per donor), the current IHT rules provide for an exemption for small gifts (£250 per donee) and for gifts on the occasion of a marriage or civil partnership (£5,000 to £1,000, depending on the identity of the donor). These exemptions have not been increased since the 1980s. Why not dispense with the smaller and more occasional exemptions, while updating the annual exemption to a more meaningful amount which could then increase with inflation going forward?

People are generally aware that most gifts made during lifetime are potentially exempt transfers ( PETs) which will come into charge if the donor dies within 7 years of the gift. However, there is far less awareness that, in certain circumstances, gifts made within 14 years of the donor's death will affect the IHT payable. This occurs where a donor has made a chargeable lifetime transfer (CLT) – for example, a gift to a company or to a trust – followed, within 7 years, by a PET. If the CLT uses all or part of the donor's IHT nil rate band, this will affect the tax charged where the donor dies within 7 years of making the PET, even though the CET itself falls outside the 7 year period. Could these computational rules be simplified to give greater certainty and clarity to donors when making gifts and avoid what may be seen as a 'trap' by affected taxpayers?

**IHT reliefs for business property and agricultural property**

The reference in the Chancellor's letter to the OTS to whether the current IHT regime *'causes any distortions to taxpayers' decisions' regarding transfers and investments may well allude to a research document published by HMRC on 22 November 2017, 'Behavioural evidence around*

*Inheritance Tax and reliefs'.* This looked at how an individual's decisions about estate-planning were influenced by IHT and, in particular, by the availability of IHT Agricultural Property Relief (APR) and Business Property Relief (BPR). Interestingly, the research concluded that relief from IHT was rarely a major factor for taxpayers who owned agricultural or business property – overwhelmingly, they were influenced by a desire to preserve the business or the farm, both for the family and for employees.

APR and BPR are among the most well-established and valuable of the IHT reliefs available to taxpayers and play a vital role in ensuring that the family businesses and farms are not crippled on the death of a major owner by having to meet a large tax bill but can be preserved as going concerns. It is to be hoped, therefore, that the Government is not considering any significant restriction on their availability. However, the fact that the research was commissioned at all suggests that the reliefs are likely to be looked at closely as part of the OTS's review.

**IHT 'Residence Nil Rate Band'**

The confusing 'Residence Nil Rate Band' (RNRB) rules should certainly be given some attention.

The RNRB rules, in force from 6 April 2017, provide for those with a net estate of between £650,000 and £2m to receive the benefit, on death, of an additional nil rate band where, broadly, the estate includes a property which passes to the deceased's children or other descendants.
The RNRB was an attempt, in light of increasing property prices in many parts of the UK, to allow parents to pass the family home to their children. However, the RNRB rules themselves are extremely complicated to interpret and apply. They also provide no benefit at all to those who have not owned their own home or who do not have children.

By simply increasing the ordinary nil rate band from £325,000 to, say, £500,000 for estates under £2m, this would all be greatly simplified and achieve the same effect.

**IHT treatment of Pensions and ISAs**

Broadly speaking, it is now more tax efficient for savings held in pensions (rather than other assets) to be passed to the next generation. Could the IHT treatment of ISAs be adapted in a similar way to that achieved with pensions, to give taxpayers greater flexibility in their investment and lifestyle decisions taken in later life?

**IHT in relation to trusts**

The Chancellor announced, as part of the Autumn Budget 2017, that the government will publish a consultation in 2018 on how to make the taxation of trusts simpler, fairer and more transparent. It is not clear how this will interact with the review to be carried out by the OTS but it is to be hoped that the review and consultation will dovetail with, and complement, each other.

Major changes to the IHT rules in relation to trusts were introduced in 2006. Those changes tended to complicate the tax treatment of trusts rather than simplify them. It would be beneficial for any review to recognise those circumstances where trusts play a positive role in succession and estate planning (particularly in providing for minor descendants) and to aim for a clearer and more straightforward regime which does not deter their use.

Finally, trusts are an important and practical way of structuring financial support for vulnerable persons; it would help many of them if the IHT rules that apply to 'disabled trusts' were both simplified and better aligned with the rules for income tax and capital gains tax.

**Conclusion**

A review of the IHT regime must be seen as a positive development, and our view is that there are a number of areas that would benefit from reform. We hope that the OTS's review will raise realistic and workable proposals and lead to a clearer, more coherent and consistent IHT regime.

On Thursday 15 February 2018 the OTS published a scoping document for its review of IHT please click here to see it. The OTS review will run alongside HMRC's project on administrative changes for estates where there is no tax to pay.

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