Inheritance Tax - Simplification but with a twist

The Office of Tax Simplification (OTS) has issued their second report into the simplification of Inheritance Tax (IHT) following recent consultations.

The consultations revealed that "there are many areas where IHT is either poorly understood, counter-intuitive, requires substantial record keeping, creates distortions, or where the application of the law is simply unclear".

The majority of the recommendations are intended to simplify IHT returns, especially where required in administering an estate, and would be beneficial for the majority of taxpayers.

However, one of the recommendations suggests removing the Capital Gains Tax uplift for assets transferred on death where IHT reliefs (such as spousal exemption, APR and BPR) have been claimed. This has been a useful planning tool to ensure that owners do not feel that they have to give away assets they need an income from too early. Removal of this provision could result in large Capital Gains arising if a gift or sale of the assets are required post death. It could also impinge on succession planning following an untimely death.

Another key recommendation is to bring the level of trading activity required to qualify for Business Property Relief in line with that required for gift holdover relief and Entrepreneurs' Relief, which raises the threshold for trading activities from 50% to 80%.

Other recommendations proposed are:

- Abolition of taper relief (which reduces the amount of tax due depending upon the period of time between a gift and death of the donor) which would create a cliff-edge whereby a gift made a day later could result in the difference between no IHT being due and IHT being due at 40%.
- Reducing the period for lifetime gifts to be brought back into charge on death from 7 years to 5 years.
- Replacement of current gift exemptions such as small gifts (£250), annual allowance (£3,000) and relief for normal expenditure out of income with a personal gifts allowance.
- Remove the need to take account of gifts made outside the 7 year period when calculating IHT due.
- Explore options to simplify and clarify rules for payment of IHT on lifetime gifts.
- Bring the treatment of Furnished Holiday Lets (FHLs) for IHT into line with the Income Tax and Capital Gains Tax treatment.
- Review the treatment of LLPs for Business Property Relief.
- Review the Pre-Owned Asset charge rules to ensure still effective.

The full report can be found at https://www.gov.uk/government/publications/ots-inheritance-tax-review-simplifying-the-design-of-the-tax.

Recommendations to simplify Inheritance Tax

Recommendation 1

The government should, as a package:

- Replace the annual gift exemption and the exemption for gifts in consideration of marriage or civil partnership with an overall personal gifts allowance,
- Consider the level of this allowance and reconsider the level of the small gift's exemption and;
- Reform the exemption for normal expenditure out of income or replace it with a higher personal gift allowance.

Recommendation 2

The government should, as a package:

- Reduce the 7 year period to 5 years, so that the gifts to individuals made more than 5 years before death are exempt from IHT and;
- Abolish taper relief.

Recommendation 3

The government should:

- Remove the need to take account of gifts made outside of the 7 year period when calculating the IHT due (under what is known as the '14 year rule').

Recommendation 4

The government should:

- Explore options for simplifying and clarifying the rules on liability for the payment of tax on lifetime gifts to individuals and the allocation of the nil rate band.

Recommendation 5

Where a relief or exemption from IHT applies, the government should:

- Consider removing the capital gain uplift and instead provide that the recipient is treated as acquiring the assets at the historic base cost of the person who has died.

Recommendation 6

The government should, as a package:

- Consider whether it continues to be appropriate for the level of trading activity for Business Property Relief (BPR) to be set at a lower level than that for gift holdover relief or Entrepreneurs' Relief,
- Review the treatment of indirect non-controlling holdings in trading companies and;
- Consider whether to align the IHT treatment of furnished holiday lets (FHLs) with that of Income Tax and Capital Gains Tax, where they are treated as trading providing that certain conditions are met.

Recommendation 7

The government should:

- Review the treatment of limited liability partnerships (LLPs) to ensure that they are treated appropriately for the purposes of the BPR trading requirement.

Recommendation 8

HMRC should:

- Review their current approach around the eligibility of farmhouses for APR in sensitive cases, such as where a farmer needs to leave the farmhouse for medical treatment or go into care.

Recommendation 9

HMRC should:

- Be clearer in their guidance as to when a valuation of a business or farm is required and, if it is required, whether this needs to be a formal valuation or an estimate.

Recommendation 10

The government should:

- Consider ensuring that death benefit payments from term life insurance are IHT free on the death of the life assured without the need for them to be written into trust.

Recommendation 11

The government should:

- Review the Pre-Owned Asset Tax (POAT) rules and their interaction with other IHT anti-avoidance legislation to consider whether they still function as intended and whether they are still necessary.

Information from 'Inheritance Tax Review - second report: Simplifying the design of Inheritance Tax', as published by the Office of Tax Simplification.

GET IN TOUCH

If you have any questions regarding Inheritance Tax, please get in touch with one of our tax experts who have extensive experience advising a broad range of clients on a variety of taxation issues.

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