

# Come to the four

It may seem that clients can only be at a disadvantage from falling house prices, but careful private client practitioners can help their clients to mitigate that risk by using the 'four-year rule' to reduce their inheritance tax bill. **Julie Butler** explains how

**W**e may officially be out of recession, but property prices are still very unstable, and private client practitioners need to be aware of what that means for their clients in terms of tax- and estate-planning. There will obviously be concerns about falling estate values, but did you know there could also actually be some advantages, too?

Obviously, there may be inheritance tax (IHT) reliefs available through business property relief (BPR) or agricultural property relief (APR). However, the argument still remains that the higher the value for IHT, the higher the subsequent value for the capital gains tax (CGT) base cost.

So how can private client practitioners take advantage of falling property prices to provide benefits to their clients?

## THE 'FOUR-YEAR RULE'

The 'four-year rule' is one of the most important tools available to a tax adviser to enable his or her clients to benefit from falling property prices, although it really is an 'emergency' solution. Sections 190-198 of the Inheritance Tax Act 1984 (IHTA 1984) permit that if, within four years of death, the property is sold for less than the agreed probate value for IHT, and there is no BPR or APR available, then the earlier IHT liability can be reduced by substituting the lower sale proceeds instead of the agreed value. The benefit for clients is that this may help save the estate IHT.

There are a couple of important points to note. First, this rule can only be used by the executors. Second, if the original plan was to hold on to the property, the sale will obviously trigger the full payment for IHT, where previously it would have been due in instalments over 10 years.

Where the property is passed by the executor to the residuary beneficiary, the executor must be mindful of the fact that, if the beneficiary sells the property, the IHT



liability will be triggered, and the 10-year option lost. The executor should therefore either retain an IHT "fund" or an "indemnity" from the beneficiary.

It is only the executors who can make this four-year claim. If the property is transferred to the beneficiary, and that beneficiary then disposes of the property within four years, they cannot take advantage of the election.

### WHERE THE SALE IS DELAYED

Where the executor knows that the value of a property has dropped because of a falling property market, and is looking for a reduction in the IHT liability to reflect this, but the search for a buyer is dragging on, the executor could end up out of time to make the necessary election to sales price, or just to take advantage of the tax relief. As with CGT, the date of sale is contract date, but it does not appear to matter for the IHT relief if the contract is conditional, so long as it does actually proceed to completion in due course. However, it is usually vital for the relief that the land concerned remains in the ownership of the executors, and is not transferred to a beneficiary.

If this happens and the executors still want to benefit from the four-year rule, they should, as the end of the four-year period approaches, prepare a contingency plan. This might, for instance, provide for a sale to an 'in-house' buyer – such as a company or a trust set up for the purpose – in the absence of completion of the sale by the intended purchaser within the requisite period. This would allow the executors to substitute a lower value into the deceased's estate, reducing the IHT bill.

### THE DOWNSIDES

The main disadvantages of a sale to an in-house buyer are the cost of stamp duty land tax (SDLT), which would normally be payable, and of additional administration costs. These additional costs would have to be weighed against the potential IHT savings before the executors could make an informed decision as to whether or not to implement this strategy.

Remember, too, that if there have already been sales of land in the first three years from the date of death, a claim under the four-year rule means that probate values of all the plots of land sold will be adjusted to sale price. If earlier sales were made at a profit, this might actually cause an increase in IHT.

Sale expenses are left out of account for the IHT relief, so they will also normally represent a CGT loss, except where the sale is to a connected person (that is, "clogged" losses.)

Questions may be raised about whether this plan of action could be open to attack under anti-avoidance rules by HM Revenue and Customs (HMRC), but this would be unlikely to be the case. An eventual sale to an unconnected third party may not take place for several years (if ever), and in any event, it could hardly be argued that there was a pre-ordained series of transactions, developed as part of a tax-avoidance scheme. In addition, the provisions for the relief have their own safeguards against abuse, in the form of a requirement to substitute the "best consideration that could reasonably have been obtained" if that is higher than the

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sale price, and also prohibiting relief for certain sales, such as a sale to a person who has a life interest in the land.

There are also detailed rules for the relief not covered here, and specialist advice is therefore advisable.

### PLANNING FOR A TIMELY SALE

The executor might find that an in-house transaction is too complicated, and that a simple sale to a third party is the way to proceed. This might mean selling in a tight timeframe, but where the IHT liability is critical, making a disposal might be the only choice. The key tax planning point is to plan the sale in good time.

### DEBATING WITH THE DISTRICT VALUER

Negotiations with the district valuer (DV) will be a key issue in relation to estates, especially where the testator died in say 2006, 2007 or 2008, when prices were high. This might result in a situation where IHT, at 40%, must now be paid on an asset the value of which has fallen considerably since the date of death.

How can the general drop in property values influence the probate valuation with the DV? The value at death has to be set in accordance with section 160 of the IHTA 1984 (that is, "market value") at the date of

death. The subsequent drop in value should only influence the market value at that time, not at the date of death.

However, the significant fluctuations in property values over the last few years have been such that many feel it is really impossible to value anything, so there is great opportunity for executors to enjoy the influence of the depressed market.

### CHALLENGES TO TAX RELIEFS

There is always an element of 'gambling' – on behalf of both the taxpayer and HMRC – if the valuation is agreed prior to the agreement of the tax status of assets in the estate. What happens if an element of BPR or APR is disallowed after the taxpayer has agreed a high value? With regard to farmland, good land agents understand the interaction of tax and values, and should work together as a team.

### CAPITAL GAINS TAX LOSS

If the beneficiary sells the property (or part of a portfolio of properties) within four years (or after four years) to produce a loss, the IHT value cannot be taken advantage of, but a CGT loss can be created by the beneficiary. The current value of this is 18% up to £37,400, and 28% from £37,401 (assuming that the basic rate band is fully available).

### SILVER LININGS

It has been said that the IHT planner and adviser has to deal with IHT-planning prior to death, and then IHT mitigation upon death – tax planning for "the dead and the nearly dead"! These are turbulent times, and tax planners must work hard to find potential 'silver linings', such as the potential IHT savings offered by the four-year rule, and to take the opportunity to promote strong arguments for tax planning-efficient values. ■

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