



IHT planning in a recession

Julie Butler looks at inheritance tax planning in a recession through disposals proceeds and the four year rule



ABOUT THE AUTHOR

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What advantages, in the context of estate administration, can the tax advisor take from falling property prices? Obviously, if inheritance tax (IHT) reliefs are available due to business property relief (BPR) or agricultural property relief (APR) the argument remains that the higher the value for IHT the higher the subsequent value for the capital gains tax (CGT) base cost.

Sale of property within four years where neither BPR nor APR available

If, within four years of death, the property is sold for less than the agreed probate value for IHT, then the earlier IHT liability can be reduced by substituting the lower sale proceeds instead of the agreed value, therefore hopefully saving the estate IHT.

If it was originally planned to hold on to the property, the sale will obviously trigger the full payment for IHT where previously it was due in instalments over ten years, i.e. as instalment option property.

Beneficiary sells the property after inheriting title

Where the property is passed by the personal representative to the residuary beneficiary, the personal representative must be mindful of the fact that if the beneficiary sells the property the full IHT liability will become due immediately and

the ten year option lost. The personal representative should therefore either retain an IHT fund or an 'indemnity' from the beneficiary.

It is only the personal representatives who can make this four year claim. If the property is transferred to the beneficiary and they then dispose of the property within four years they cannot take advantage of the election.

Personal representatives know the value has dropped but there are problems with a sale (again no BPR nor APR)

Where the personal representative is looking for a reduction in the IHT liability to reflect a falling property market, and the search for a buyer is dragging on, the personal representative 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 capital gains tax, the date of sale is the 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. But it is usually vital for the relief that the land concerned remains in the ownership of the personal representatives and is not transferred to a beneficiary prior to completion.

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If the personal representatives are approaching the end of the four year period, they should prepare a contingency plan. Near the time limit, in the absence of completion of the sale by the intended purchaser, perhaps the land could be sold to an 'in-house' buyer – such as a company or a trust set up for the purpose? Then the sale would allow the personal representatives to substitute a lower value into the deceased's estate, and the IHT bill would be reduced.

The downside costs of four year plan

If this emergency solution has to be implemented, it would not be without cost. Stamp Duty Land Tax (SDLT), for example, would normally be payable. The additional costs would have to be weighed against the potential IHT savings before deciding whether to implement it.

Could this plan of action (a sale to an in-house buyer) possibly be open to attack under anti-avoidance rules by HMRC? An eventual sale to an unconnected third party may not take place for several years (if ever). In any event, it seems difficult to argue that there was a pre-ordained series of transactions as part of a tax-avoidance scheme so therefore this should not be a downside. 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 sale price, and also prohibiting relief for certain sales, e.g. a sale to a person who has a life interest in the land.

The disadvantages are the cost of SDLT and additional administration costs.

Remember, too, that if there have already been sales of land in the first three years from the date of death, a claim means that probate values of all the plots of land sold are adjusted to sale price. Earlier sales may perhaps have been at a profit so they will cause an increase in IHT.

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

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

Timely sale to reduce the IHT – plan ahead

The personal representative might find that an 'in-house' transaction is too complicated and that a simple third-party sale is the way to proceed. This might mean selling in a tight timeframe, but where the IHT reduction available is substantial, 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

District Valuer (DV) negotiations are going to be a key issue with estates where the testator died in say 2006, 2007 and 2008 when prices were high, and IHT at 40 per cent is going to be paid on an asset whose value has fallen considerably since the date of death.

How can the general drop in property value influence the probate valuation with the DV? The value at death has to be valued in accordance with s.160 *Inheritance Tax Act 1984* (IHTA) at market value at the date of death. The subsequent drop in value should only influence the market value at *that* time not the date of death.

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However, it is considered that at the time of writing it is impossible to value anything; therefore there is great opportunity for the personal representative to enjoy the influence of the depressed market.

Valuation where BPR or APR are available but subject to challenge

There is always an element of 'gambling' (on the behalf of 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.

Sale by the beneficiary

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 capital gains tax (CGT) loss can be created by the beneficiary. The current value of this is 18 per cent.

The 'dead and the nearly dead'

It has been said that the IHT planner and advisor has to deal with the IHT planning prior to death and IHT mitigation upon death – tax planning for 'the dead and the nearly dead'. These are changing turbulent times and the opportunities must be taken to use, for example, the election to replace original valuation at death with subsequent sale proceeds where values have dropped, and to use the opportunity to promote strong arguments for tax-planning efficient values. ■