

Death, Taxes and Penalties: greater pressure on recording and evidence

especially those who consider the tax unfair as for many it is seen to be taxing retained earnings twice. It is therefore important to beware of the relatively new penalty regime which could add further to the liability.

Behaviour Based Penalty Regime

The behaviour based penalty regime was introduced by Schedule 24 FA 2007 from 1 April 2008. It was believed to be HMRC showing that they wanted to punish those who do not comply with heavy penalties for non-disclosure. Schedule 40 FA 2008 extended the behaviour based penalty regime introduced in Schedule 24 to IHT.

At a practical level the HMRC approach to IHT enquiries has moved from "benign to battling". It has been said that the only two certainties in life are death and taxes and the penalty on incorrect disclosure is still uncertain but enquiries into farming estates is certain post 1 April 2009.

A case heard by the Tax Tribunals last year (G D Cairns) also serves a warning to others. The executor estimated the value of a property which was almost derelict and did not obtain a professional valuation. It was in any event to be sold as quickly as possible. As it turned out, it sold for much more than the executor's estimate of value and so the executor immediately declared the higher amount to HMRC and paid the additional tax. Even so, HMRC issued a penalty for negligent conduct in view of the substantial initial under declaration. The Tax Tribunal upheld an appeal against the penalty, but others may not be so fortunate – with penalties everything depends on all the facts of the particular case.

Areas of Review by HMRC

Areas of the IHT account that HMRC have been known to look closely at following the submission of IHT 400 are as follows:

- Under valuations where there are no IHT reliefs available;
- Over valuations where there are reliefs and the high value could benefit tax relief in the future, e.g. base costs for Capital Gains Tax (CGT);
- Incorrect claims for reliefs, e.g. Business Property Relief (BPR) where there is no business carried on for gain, where there is an investment business not a trading business (IHTA 1984 s.105(3));
- Omitted assets at date of death;
- Omitted lifetime transfers.

In practice it is less likely that an asset held at death is omitted by the Personal Representative than a lifetime transfer. All assets must be ascertained at date of death and included in the Estate Accounts and distributed, whereas correctly recording the lifetime transfer will depend on the gathering of historic information and good record keeping.

The penalties are shown as a percentage of "Potential Lost Revenue" (PLR) – that is potential lost "tax take".

Personal Representative (PR's) behaviour giving rise to error	Voluntary disclosure Disclosure prompted by HMRC
1. Misinterpretation or mistake	0%
0%	
2. Careless inaccuracy" failure to take reasonable care	0-30% 15-30%
3. Deliberate overclaim or understatement	20-70% 35-70%
4. Deliberate understatement aggravated by concealment	30-100% 50-100%

HMRC have issued guidance aimed at helping taxpayers avoid a penalty for failing to take reasonable care with their tax affairs. HMRC are able to charge a penalty on a third party from 1 April 2010. This position will only apply if a third party deliberately withholds information from or deliberately supplies false information to another person who has to complete a return or send HMRC a document. In order to apply the penalty HMRC have to be able to show that the third party intended to cause the other person's return to be inaccurate.

What is helpful behaviour by PRs?

The question has to be asked – what is helpful behaviour for PRs? HMRC evaluate what is helpful behaviour by how much the PR's behaviour involves "telling" "helping" and "giving". In the same way HMRC officers are encouraged to build a picture of the deceased when investigating the IHT accounts, the PRs are expected to carry out checks and look for mismatches. This responsibility puts a lot of pressure on PRs.

For example, ensuring that the deceased's tax return corresponds with the IHT return, i.e. income from property to match property held should be a routine check by the PR or their agent.

Another area whereby a PR can win HMRC support is by paying significant (and relevant) payments on account of any anticipated extra tax liability. This can be seen by HMRC as an important sign of willingness to co-operate and can cause penalties to be reduced. Once an omission is found by a PR it is suggested not just to disclose part of the missing information – disclose the whole amount and as much relevant information as possible.

Agricultural (APR) and Business Property Relief (BPR)

PRs can anticipate that APR and BPR claims will be queried. HMRC instructions are not to waste resources where there is little tax involved. The tax advisor should therefore agree a strategy with the client. There has been a number of recent Special Commissioners (1st Tier Tribunal) cases on the question of s.105(3) IHTA 1984 and the existence of an investment business.

It could be that a business that was a strong trading activity has moved more and more towards investment business as the tax payer became older. A prime example of this investment angle is a farm which "lets out" more and more of the buildings, land and property previously used for the farm trade. Diversifying into rental income activity from the previous trading activity will obviously create concerns under s.105(3) IHTA 1984. Clearly the penalty system will cause problems to the Estates of farmers and landowners. A constant review of compliance and available evidence will be important during the life of the landowner.

Action Plan

The first practical steps to take by owners of substantial estates are both good lifetime record keeping and IHT relief compliance review. At the very least if IHT reliefs such as BPR and APR are to be claimed then constant compliance checks should be undertaken. Lifetime transfers and loans should be well recorded. After death there should be robust checks between income tax and IHT recording prior to submission of the form IHT 400 to HMRC.

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