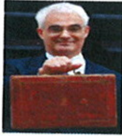
FARMERS WEEKLY INTERACTIVE

Doing nothing is a risky inheritance tax strategy



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Inheritance tax has long been a favourite political pawn but, whatever the Budget brings, farmers still need to plan carefully for this valuable tax concession.

It can be argued that all land and most buildings have a degree of potential development or "hope" value. There will always be some opportunity to "grow" more houses, improve buildings and convert barns. The problem to consider is how will this value be protected to ensure inheritance tax relief is achieved on either the potential or the development proceeds.

Risks of the "do nothing" strategy

If the potential development asset is held within a business, like farmland within a large working farm, there is temptation to do nothing for now and worry about it later.

But when potential development land is owned by the elderly farmer or the landowner with health problems, what action can be taken?

Where potential development land has not obtained planning permission there is often no guarantee that the development land or a substantial part of it will be sold during the lifetime of the landowner. It is not just the elderly who are "inheritance-tax-vulnerable" - it can be anyone who is about to realise the development in the near future.

If the estimated time for obtaining planning permission is, say, three to four years in relation to a substantial proportion of the development land, then there is a realistic risk that the landowner would still be alive when the development is realised and the value of his estates for IHT purposes would increase very substantially.

This is because the hope value would have been realised. There is always a substantial leap in value, which reflects the change from a probability of planning permission to a certainty.

Any cash or binding contract for sale would not qualify for Business Property Relief (BPR). This is because either the surplus cash would be regarded as an excepted asset.

There could be a nightmare situation where the farming business holds the cash and is therefore deemed to be an investment business. This is because either the cash or the investment in development land is greater than the trading activity.

Reinvesting the development proceeds

Of course, there still would be the prospect of reinvesting the cash proceeds in other farmland or other businesses, which qualified for BPR.

There is case law to support the proposition that the cash would not have had to be reinvested at the time of the landowner's death to avoid being an "excepted asset" so long as there was a credible plan for reinvesting it in a manner which qualified for BPR. But, to make this convincing, there would have to be clear documentation of this intention.

There are very considerable practical and commercial obstacles to reinvesting that amount of money from a large development within a relatively short timescale:

A From a commercial perspective it would be sensible to stay with the businesses that the landowner (or people close to the landowner in whom he had sufficient confidence to delegate the management of a business) understood and could manage

B If the consideration in A limited the business which could be looked at to that of farming, it might well not be easy to acquire sufficient quantities of additional land, of the right quality in the right location and at a sensible price, for the replacement land to be incorporated effectively into the same business

C There would be a fundamental question of who was going to manage this greatly expanded farming enterprise and whether the landowner would have the energy to carry out the management.

Therefore there is the substantial risk that, if nothing is done with potential development land, there will be an IHT charge at 40% on the full amount of any realised development value, to the extent that that realised development value was not reinvested in qualifying assets. Such an IHT charge will be more onerous than a Capital Gains Tax charge which is likely to be at a much lower effective rate - 18% at the moment.

CGT and IHT battling for importance

The question of "doing nothing" against making gifts of assets during one's lifetime highlights the downside risk of increasing the "effective rate" of CGT and weighing this against the upside benefits in terms of reducing IHT.

It is assumed that the lifetime gift is at a lower value before the full value is realised.

The advantage of "doing nothing" is that if a person makes no actual or deemed disposal of an asset during his lifetime, he will incur no CGT liability. His estate will then obtain the benefit of the CGT-free step up in base cost. Therefore, the landowner's personal representatives, if they choose to sell part of the land, are more likely to realise a smaller gain and therefore suffer a reduced CGT liability.

Conclusion

With regard to IHT planning, if a farming landowner, or general business landowner is holding potential development land within their business with a view to sheltering potential IHT, there are serious risks of "doing nothing" as the development project approaches.

Serious thought must be given to gifting to the next generation. The complexity and technical concerns of making gifts of assets within one's lifetime must be given full consideration for all potential development projects. "Doing nothing" is not an alternative that can be assumed without working through considerations of lifetime giving.

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