Tandem taxes

Julie Butler outlines the importance of marrying a capital gains tax strategy with inheritance tax planning

With the recent budget announcement of the reduction in the rate of capital gains tax (CGT) from 28 per cent to 20 per cent for non-business assets, there will be a lot of focus on CGT planning. This will include the review of tax strategy around the approach of death. No matter how morbid the subject, it is something that must be faced.

As 'death is not a chargeable event for capital gains tax' it might be wondered, at a superficial level, why there is capital gains tax planning around death. It can be argued that death is something that is difficult to plan for in tax terms, as we never know when this will happen. However, there can be some very effective generic and death bed planning with regard to inheritance tax (IHT). For IHT protection, it is key to make sure that all the facts, evidence and legal documents etc. to support the tax reliefs are in place.

To achieve business property relief (BPR) for IHT, the property must have been owned for a minimum of two years and used in the business. In addition, there must be active involvement in the business by the deceased and in the years before death; this can be complex. The role of the agent and lasting power of attorney (LPA) can be strong tax planning tools. The date of death can be planned for in terms of IHT, but in terms of capital gains tax (CGT) the matter is more complex. Such CGT planning is often forgotten about by both the family of the deceased and tax advisers. Let's look at the CGT angles in more detail.

CGT losses carried back

The general rule is that capital losses that cannot be utilised in the year of assessment in which they arise are carried forward under section 62(2) TCGA 1992 apart from in the year of death. Tax planning around CGT losses can therefore be very important for elderly clients. If a taxpayer incurs capital losses in the year in which he or she dies, the losses can be set against the capital gains of the three preceding years (for guidance see CG 30430).

Firstly, the capital losses of the tax year of death must be offset against gains of the same year. Once the current year's gains have been offset against losses, any surplus losses can be carried back against the gains of the preceding three years. Clearly the identification of any negligible value claims while the taxpayer is alive is of prime importance in CGT planning terms.

The risks of negligible value claims

Executors face several risks with regard to negligible value claims for CGT. Guidance for such claims is found in the frequently asked questions (FAQ) section of HMRC's website for personal representatives. The HMRC website clearly sets out the fact that 'income that the deceased received and capital gains that he made for the period to the date

of death are taxed in the normal way'.

The guidance also explains the further risk faced by executors where it states that, if the personal representatives 'fail to claim a repayment due to the estate [in respect of negligible value claims] you may have to make good the loss to the estate'. Ideally the planning work around negligible value claims should be sorted before death.

CGT losses – tax year before death

From a tax planning viewpoint, CGT losses brought forward from the year before death can be a problem. There are none of the advantages of the 'terminal' CGT loss relief of the year of death as set out above. The CGT losses from the year before death could in such a case be 'lost'. For most elderly clients, a close review of CGT losses brought forward to see how these can be utilised is essential.

It is good practice for taxpayers who own shares in a failed company or any other asset that has become worthless, to consider making a negligible value claim to crystallise the loss for capital gains tax at an early stage. Where appropriate, a negligible value strategy should form part of 'death bed' planning to enable the loss to be used against other capital gains in the same or a future tax year, and try to ensure that they are not lost. The problem is the tax year before death, but who knows when that will be?

Tax inefficiency can arise when there is sudden death and there is an unused negligible value claim or other losses carried forward for tax years other than the year of death. These CGT losses will be lost. The tax planning around the year of negligible value claim or date of disposal can be critical. It can be argued that it is sensible to leave negligible value claims to executors. Likewise, tax planning around the date of claim and also possible sales has to be considered before the date of death, i.e. should an asset containing a large loss be realised before death? The answer is to consider all the facts.

IHT value – CGT base cost

A fundamental consideration is that the probate value under section 160 IHTA 1984 is the base cost for CGT for future disposals by the executors or beneficiaries. Passing the farm or business to the next generation as a gift on death will produce a capital gains 'tax free' uplift, because the uplifted probate value will replace the historic base cost.

The transfer of assets on death combines favourable inheritance tax reliefs with increased capital gains tax base costs, providing the 'tax free' uplift to probate value. For some clients, CGT planning needs to be taken with equal respect as IHT planning.

<u>Scenario 1</u>

Shares in Company A	£
Cost	100,000
Value at death	-20,000
CGT Loss	80,000
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IHT at 40 per cent on £20,000 = £8,000

If the sale of the shares in Company A is made in the year of death, the CGT loss can be carried back against capital gains of the three previous years. Where a client is ill, this must be reviewed on a regular basis.

If the sale is made in the tax year before the tax year of death, there will be no carry back advantage of tax losses and they can only be offset in the year of disposal. A constant review of negligible values, large drops in value and good CGT planning before death is essential for tax advisers.

An example of this CGT planning is to do with the Single Farm Payment. While this is obscure, it does help make the point.

On the Purchased Single Payment Scheme Payment Entitlement in Northern Ireland, Scotland and Wales, HMRC clarifies as follows:

'In Northern Ireland, Scotland and Wales, all Single Payment Scheme Payment Entitlement will cease to exist on 31 December 2014. HMRC accepts that Single Payment Scheme Payment Entitlement in Northern Ireland, Scotland and Wales became of negligible value on 16 May 2014 because 15 May 2014 was the last day that the entitlement must have been held in order for a person to establish that they were eligible for a payment under Single Payment Scheme. A negligible value claim may be made to HMRC in relation to an entitlement on or before 31 December 2014, subject to the conditions for a valid claim being met.'

The negligible value claim has to be made in the tax year 2014/15. Thus should the taxpayer die in 2015/16, the CGT losses could be lost. The terminal CGT loss that can be made in the year of death, re carry back of losses. Hence highlighting the fact that when losses are made when a client is ill the forward planning should be highlighted.

There is another area for tax advisers to consider: inherited entitlements with farming clients. These should have been valued at death and passed over per the Will with the land. There is a CGT negligible value claim to make in respect of these inherited entitlements.

The CGT negligible loss claim could be lost where there are no gains to offset and planning should be put around this. Land agents often omit the entitlements from the probate valuation.

Action points

All CGT losses that are carried/brought forward will need to be reviewed for maximum efficiency. It is very easy to leave CGT losses brought forward as a rather 'lonely' figure on the tax return. It is imperative to keep CGT planning moving hand in hand with IHT planning.

For advisers, all negligible value claim opportunities should be regularly reviewed and the strategy of negligible value claims should be considered by all taxpayers, including executors for deceased taxpayers. There is no better time to deal with tax planning and compliance around such claims than with a change in rate of capital gains tax. ■

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