Inheritance Tax Review

Call for Evidence Response: Wedlake Bell LLP

Wedlake Bell LLP is a central London law firm over 200 years old. It has 61 partners and is one of the top 100 firms in the UK on turnover[1].

The firm welcomes the opportunity to respond to the Office of Tax Simplification's call for evidence in respect of its review of inheritance tax ("**IHT**") dated April 2017 ("**the Consultation**").

Consultation Question 1

If you have completed an IHT form, please state which form(s) you completed and whether you completed them in your professional or individual capacity. Please describe any problems you had in navigating the form(s) and provide any suggestions you have on how the form(s) or related guidance could usefully be simplified, made clearer or made easier to complete.

We complete a range of IHT forms in our professional capacities in connection with our advice to trustees and executors in the administration of trusts and estates. These forms include the IHT100 suite of forms for reporting chargeable events in relation to trusts and the IHT400 suite of forms (and the related IHT205 and IHT207 forms) for reporting the IHT liability of an estate.

We do not have any specific problems to report in relation to these forms and find that they work well and are straightforward to navigate; however, we would note that consistency and familiarity are key to the ease with which these forms can be used. The main reason we do not have any issues is because the contents have been kept relatively consistent for a long period of time; thus, the forms are familiar to professionals and can therefore be completed efficiently from a time and content perspective. In our view, changes should only be made to these forms if absolutely necessary. We do not have any necessary changes to recommend.

Consultation Question 2

In general, the deadline for payment of IHT is six months after death, whilst the deadline for submitting the relevant IHT form is twelve months after death. Please describe any problems or issues that arise because of this.

The six month payment window can be a problem on complex estates as it does not provide sufficient time for the IHT lability to be assessed. Obtaining valuations for certain assets, such as an interest in a business, can take in excess of the six month window, meaning that the executors do not have an accurate valuation at the time the IHT is due. Whilst a best estimate can be used, this results in additional time being spent (both by us and H M Revenue & Customs ("**HMRC**")) when the professional valuation is complete and the IHT due on the assets may need to be revised. We are in favour of the payment and filing windows being aligned at twelve months to allow sufficient time for accurate valuations to be obtained and a greater likelihood of the IHT payment being "final". This would reduce unnecessary time being spent by executors at later stages adjusting the figures and arranging for top-up IHT payments; and, from HMRC's perspective, reviewing such adjustment and arranging an IHT refund. Additional assets often come to light in the course of administration which may not be known about within the first six months; setting a twelve month period for IHT payment and filing would increase the likelihood of the whole estate being reported in one IHT account, and save the need for HMRC to review corrective accounts.

[1] The Lawyer's top 200 UK law firms 2017 by revenue (ranking: 81).

As a final point, the interest payable by HMRC on over-payments of IHT is currently 0.5% which is lower than the executors and/ or beneficiaries could achieve if the same funds were invested for the benefit of the estate. Lengthening the payment window to twelve months would reduce the likelihood of a refund being due and enable the executors to maximise the value of the estate for the benefit of the beneficiaries.

Consultation Question 8

Have you been required to obtain a valuation of assets for the purposes of completing an IHT form? Was there any difficulty in doing so? Was the cost of the valuation commensurate with any IHT payable? What could be done to simplify the process?

We regularly obtain valuations in order to complete the IHT forms for the estate we administer. For the purposes of this question, we would comment in particular on valuations of property. We generally obtain a professional valuation from a surveyor who is a member of the Royal Institute of Chartered Surveyors ("**RICS**"). This comes at a cost to the executors both in terms of the fee, and in our time in instructing the surveyor, liaising with them on the preparation of their report, and reporting to the executors on the valuation. A typical fee for a RICS valuation would be in the range of £2,500 to £5,000. However, in our experience, HMRC nearly always queries valuations where the property involved is in excess of £1million, regardless of the RICS valuation, and the District Valuer is instructed to provide their own valuation. In our experience, in the majority of cases, the District Valuer's valuation is not significantly different to the initial RICS valuation, meaning that the time and cost of obtaining that initial valuation and liaising with the District Valuer, have, from the executors' point of view, been wasted, and resulted in an unnecessary cost to the estate. We would suggest that the policy of regularly instructing the District Valuer to review valuations of properties in excess of £1million (where there is already a RICS valuation) be reviewed in the interests of saving estates time and money, as well as valuable HMRC time and resources.

Consultation Question 13

Do the different requirements for trading across BPR, CGT gift relief and entrepreneurs' relief cause complexity and, if so, how could this be addressed?

The different definitions of "trading" for the purposes of Business Property Relief ("**BPR**"), Entrepreneurs' Relief ("**ER**") and business assets holdover (or "gift") relief ("**Business Holdover**") make the system of capital tax relief for business assets difficult to understand for our clients. Situations can arise where the client's business is in the category of 51%-80% trading, such that the business will qualify for BPR but not Business Holdover or ER. The disparity between the rules can be difficult to explain to clients, and in our experience has proved unpopular. Simplicity and consistency in the tax sphere are key factors for clients and this is one example of where these two factors are not well demonstrated for not obviously logical reasons. The result impacts lifetime giving of business assets, and for clients in the category highlighted above, discourages them from passing on business assets during their lifetime because of the capital gains tax ("**CGT**") cost. The option of retaining the business assets until death, at which point the CGT uplift will apply, is often more attractive, but this comes at a personal cost to the client and their family; it reduces their estate planning options and, in relation to family businesses, provides the younger generation with less of an incentive to be involved in the business if there is a significant delay in them receiving a share in it. An alignment of the "trading" definition across the IHT and CGT reliefs would provide tax-payers with clearer estate planning options and potentially allow wealth to flow down to younger generations more freely, which would potentially have the side benefit of improving the societal "wealth gap" issue.

One further point however. Having been around for over 40 years, BPR is a long-standing and well established tax relief. The qualification conditions are, in comparison with ER, relatively simple and, in our experience, fairly straightforward to explain to clients and, as a result, well understood. ER is more complex and difficult for clients to understand, and therefore take into account in their planning. In the interests of simplification, we would favour a system that retains BPR in its current form, with the benefit of its long established body of case law.

Consultation Question 19

Please tell us about any other areas of complexity in applying any IHT rules, reliefs or thresholds not already mentioned in your response, along with any suggested improvements. You may, for example, wish to comment on the residence nil-rate band, the IHT treatment of trusts, the IHT treatment of personal pensions and life insurance products, or the conditional exemption for certain works of art or heritage assets.

We would like to comment on the residence nil-rate band ("**RNRB**"). Whilst the introduction of an effective extension to the standard nil-rate band is welcome and long-awaited given the freeze on the standard nil-rate band since 6 April 2009, the way in which the relief is structured is hugely complex and difficult for tax-payers to understand; consequently preventing tax-payers from making effective use of it.

Some of the complex elements of the RNRB are as follows:

- the requirement for lineal descendants of the deceased to inherit the property. Many clients are unaware that eligibility for the relief depends on to whom the family home passes, as this is not how the standard nil-rate band operates. It is also a discriminatory aspect of the relief and on which we comment further below;
- the restriction of the relief to gifts on death and not gifts during lifetime. The standard nil-rate band applies to lifetime gifts and is "refreshed" every seven years. Clients find this disparity difficult to understand and take into account in their estate planning. It is possible that tax-payers who have not taken professional advice, but relying on how the RNRB has been reported in the press as "an additional IHT relief for the family home", are carrying out planning with the family home during their lifetimes in reliance on the RNRB applying to the gift;
- the definition of "inherited" and its restriction to absolute gifts, certain (but not all) gifts on trust and the anomaly that lifetime "gifts with reservation" can qualify under the RNRB rules. Many clients' Wills which were drafted prior to the RNRB being introduced will not qualify without amendment. We comment more on this below;
- technicalities with "inheriting" a property held in a life interest trust. Specifically, the trustees' overriding powers under a life interest trust can prevent a child who inherits absolutely for trust law purposes on the life tenant's death from inheriting "absolutely" for RNRB purposes. This is a trap that beneficiaries can unwittingly fall into without paying for professional advice;
- the calculation of the RNRB which involves assessing the "residential enhancement", "brought-forward allowance", "default allowance" and applying the taper threshold. It is likely that many lay tax-payers will need professional advice to comprehend the calculation, or will need to seek advice from HMRC which will inevitably take up HMRC's valuable time and resources; and
- the calculation of the "downsizing addition". This adds a further layer of complexity and is in our experience nearly always impossible for a lay tax-payer to understand and calculate without professional advice, or recourse to HMRC.

The result of the complex way in which the relief has been structured is that clients do not understand the rules. Many assume that because they own a property, they will be entitled to the relief automatically and do not take any action to amend their Will. However, if the Will does not include a qualifying gift to

children, the relief will be lost. This might be the case, for example, if the children inherit with contingent interests, or under a discretionary trust and the executors/ trustees do not take professional advice about using the "writing-back" effects of s.144 Inheritance Tax Act 1984. Other clients do take advice, but the time needed to explain the complexities of the relief and the way in which it impacts the decisions they make about their Will and estate planning, means that professional fees for preparing a Will will surely have increased for those clients affected since the introduction of the RNRB. This could have the result of discouraging clients to make a Will, or to seek advice on the RNRB.

Some further points on the RNRB are as follows.

- The way in which the RNRB is limited to lineal descendants is discriminatory to those without children. The standard nil-rate band is not similarly restricted. We can see no fair policy justification for limiting the relief to those who can or want to have a family. The qualification should attach to the residence that you own at death (or have downsized before death) without any restriction on to whom this passes.

- The introduction of the RNRB has been used by the government to justify a continued freeze since 2009 on the standard nil-rate band at £325,000. However, those without children who are unable to benefit from the RNRB, are therefore limited to £325,000 IHT relief which, when the average price of property in London is £471,944 and the South-East £320,682[2], means that a greater proportion of the estate is unfairly pushed above the nil-rate threshold and subject to IHT. A simple and straightforward increase in the standard nil-rate band to take into account, at least to some extent, inflation since 2009, would benefit everyone.

- The taper threshold of £2million encourages those on the cusp of this amount to actively embark on tax planning in order to reduce their estates below the threshold. Whilst such tax planning is legitimate if done within the boundaries of the UK's tax avoidance regimes; if professional advice is not sought, there could be tax avoidance issues that may go undiscovered by HMRC. Similarly, a taper threshold which puts pressure on taxpayers to give away assets can lead to elderly tax-payers being coerced into making gifts that they do not want, or may not have the capacity, to make. Instances of elder financial abuse could accordingly increase.

- Advice on the RNRB can be particularly complicated where, due to the taper threshold, spouses/ civil partners need to structure their Wills to make use of the relief on the first death if the combined estate will exceed the threshold but a single estate will not. Making use of the relief in this scenario could introduce a potential conflict situation between executors/ trustees, the surviving spouse/ civil partner and children, particularly in second marriage situations, as the interests of the survivor and children may not be aligned (the children wanting the relief to be utilised, and the survivor preferring to keep ownership of the property at the expense of the relief). This increases the likelihood of litigation and family conflict, and potentially puts executors/ trustees in a very difficult position where they are forced to choose between the two sides. Some executors/ trustees may decide that they cannot continue in the role as a result.

Whilst we appreciate that the RNRB rules are still in their infancy, having only been introduced in April 2017, and making amendments to the rules so soon would usually be avoided, we are of the opinion that the need for simplification and fairness outweighs the need for continuity in this situation. Making an increase in the standard nil-rate band would be far more straightforward for tax-payers to understand, and HMRC to assess and deal with, than the present system. If this cannot be accommodated, at minimum we would suggest that the RNRB rules are amended to remove the discriminatory requirement for lineal descendants to inherit.

Wedlake Bell LLP

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Ref: SAB

[2] From UK House Price Index summary: March 2018 (published 23 May 2018).