

Inheritance Tax Review

Scottish Land & Estates (SLE) is a membership organisation for owners and managers of land, property and businesses across rural Scotland. While rural businesses operate in a different context to urban businesses they provide a range of employment opportunities in farming, estate management, tourism and in the provision of housing amongst other things and are a key part of the rural economy. SLE has a Taxation Group which is formed from a number of professional members who closely monitor fiscal policy and application and representatives have met with the Office of Tax Simplification (OTS) to discuss this review, along with CLA whose position is largely in line with our own. We are therefore pleased to respond to the call for evidence by the OTS on its review of Inheritance Tax (IHT). While we welcome the aim of the IHT review to make the regime “*fit for purpose*” we would hope that this is not change or alignment for the sake of change or alignment, but to genuinely simplify some of the unnecessary complexities and administrative burdens.

Reliefs from inheritance taxes for businesses are common throughout the developed world and SLE is firmly of the view for the reasons set out in answer to the questions below that APR ought to be retained as a relief from IHT. We are also strongly in favour of retention of the “wholly or mainly” trading to investment test for BPR, again as noted in response below. In relation to the payment deadline for IHT we believe this should be extended from 6 months to 12 months, in alignment with filing of the IHT forms.

Overall, while we appreciate that the OTS does not have a policy remit, SLE is clear that any significant alterations to IHT and IHT reliefs at a time of transformational changes to the farming sector with the potential implications of Brexit and removal of direct payments should be examined in that wider context. Rural businesses require flexibility to adapt to changing circumstances to increase productivity and accelerate growth for the benefit of the wider UK economy.

Payment and forms

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 forms or related guidance could usefully be simplified, made clearer or made easier to complete.

SLE believes that the forms could potentially be simplified and made more ‘user-friendly’, but will leave exact suggestions as to the best way to achieve this to legal and taxation practitioners. However, any duplication should be avoided and where possible schedules to the IHT account could be kept concise and shortened.

2 In general, the deadline for payment of IHT is 6 months after death, whilst the deadline for submitting the relevant IHT form is 12 months after death. Please describe any problems or issues that arise because of this.

SLE considers that IHT tax calculations can be difficult to follow for our members and for lay people more generally. It is important that HMRC apply reliefs correctly and that errors by HMRC are minimised. Overall, it would make sense to align the deadline for payment with the deadline for filing. It should be borne in mind that the potential of paying in instalments does not obviate the difference in the actual deadlines. The viability of a rural or other business could be seriously affected if a farmer has to sell up his/her business assets in order to fund an IHT liability and many SLE members may be regarded as asset rich, but cash poor. The selling of a business could have significant impact given land in the area may not be readily available in future years, even in a generation. As per question 1, we would also suggest alignment in the dates would avoid unnecessary duplication of work.

Probate

3 Does this process create practical difficulties? Bearing in mind the benefit of this mechanism, what could be done to address any such difficulties? To what extent does the instalment payment option where the IHT is attributable to certain assets in instalments help mitigate any issues?

SLE has no direct involvement in the Confirmation process in Scotland, but would suggest that prompt and clear communication with the parties involved is vital and in particular where there are executors that HMRC expectations should be proportionate and common sense. We certainly support recent improvements such as published HMRC timeframes. It should always be remembered that IHT is not the only consideration, but is triggered by an emotional occurrence.

Estates that do not have to pay IHT

4 Are there any disproportionate administrative or compliance burdens in establishing whether the value of the estate is below the NRB, or where the spouse exemption applies? How could these be reduced?

SLE considers that there should be a much simpler online filing system for simple return where there is no IHT to pay eg where estates are below the nil-rate band or on passing to spouse.

5 Could the guidance on www.gov.uk be improved to support people handling estates on which no IHT will be paid? If so, how?

SLE has not had recourse to refer to this guidance and will leave to others to make comment.

6 Are there other steps that government could take to raise awareness of the NRB to reduce anxiety around liability to IHT for people who don't have to pay it?

SLE does not have any comment to make in relation to this question, but welcomes the premise of ensuring full awareness.

Administering an estate, record keeping and valuations

7 What, if anything, could be done to help executors administer an estate and fulfil their obligations?

SLE considers it worthwhile for HMRC to consider some of the more complex areas of IHT and to provide further guidance on those types of more technical situation which arise, but are not routine. While time may be involved in preparing guidance, this may be a long-term win in terms of reducing correspondence and telephone contacts overall due to better

understanding. We believe the IHT 100 form is somewhat cumbersome and complex to fill out. We also understand there is some confusion around the residence nil-rate band.

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 this process?

SLE has not been directly involved in obtaining a valuation of assets. However, we do understand that while a valuation is relatively easy to obtain, there can be issues around non-agricultural values, such as sheds or the farmhouse, which results in much work for district valuers and differences with the estate's valuer.

Lifetime gifts to individuals

9 Are there any aspects of the interaction between the thresholds and exemptions relating to lifetime gifts that you find especially distortive or complex to understand and apply? Please provide examples.

SLE has no comment to make on this question.

10 How, if at all, should these rules be simplified? What could be done to improve public understanding of the rules? Have you found that the joint liability of the estate and the person receiving the gift can cause problems for executors or HMRC?

SLE has no comment to make on this question.

11 How, if at all, could the monetary thresholds and the various lifetime exemptions be simplified?

The main point we would make in relation to this question is that the thresholds themselves have not been increased for many years and have not kept pace with inflation.

Businesses

12 How, if at all, does the IHT framework, including the related tax considerations set out above, make business decisions challenging? For example, does it affect or distort decisions regarding:

a) whether to sell or transfer a family business to another vehicle or directly to the next generation during lifetime or wait until death,

b) the structure of the business (for example, how to hold non-trading assets),

c) the choice of business vehicle (for example a corporate entity, partnership, unincorporated business), or

d) investment in unlisted trading companies (including those traded on the alternative investment market (AIM))?

In relation to this question we would simply note that all estates which include business assets will face a substantial tax charge as the value of these assets will far exceed the nil rate band and be chargeable at 40%. This is specifically the case where the deceased spent a lifetime building up the business. Where funds are not available to pay the IHT charge then disposal of assets or taking on debt may be the only way to make such payment. Clearly these can have a damaging impact on the continuing viability of the business putting jobs at risk. The reliefs are therefore welcome and any recommendation to restrict or tighten

the reliefs could threaten the viability of businesses facing larger IHT bills. A forced sale of land for tax reasons would make investment even less worthwhile.

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? Are there any other inconsistent definitions or approaches either within IHT, or across IHT and CGT and if so, does this cause complexity? Do you have any other suggestions as to how to remove complexity around the interaction between CGT and IHT?

SLE is clear that simplification is not necessarily about alignment. In the case of IHT payments and filing we believe there to be a clear practical case for this as set out above, but in relation to the trading/investment test alignment would be completely inappropriate. Entrepreneur relief is aimed at fast growing businesses and encouraging entrepreneurship which is quite a different policy context. If anything, it is more about giving business owners the incentive to build a business and move on as opposed to ensuring business continuity like IHT. If the test were changed from 51% trading: 49% investment to an 80% trading: 20% investment test this would make it much more challenging to secure IHT relief on death. It could well encourage businesses to artificially alter their structures to fit into the new test. SLE is concerned that it could encourage businesses to sell off cottages and sheds that are investment assets, impacting on the let rental sector and putting more pressure on rented housing elsewhere. This 'increase' in tax, were it to occur, is "all or nothing" and would weaken and fragment mixed estates on death or certain lifetime transfers. In contrast the current BPR test provides for stability and transfer of know-how and is simpler for businesses to operate in than the more difficult 80% bar. We believe a great deal of additional complexity would arise if the test were to be changed from "wholly or mainly" to "substantially" as there will be so many more that are marginal or fail. Also, with current uncertainties in the future of land prices and farm support income due to Brexit, there could be quite serious fluctuations in the capital value, turnover and profit tests that are outside the control of the business owner.

In the context of diversification, the 'wholly or mainly' test has become increasingly important for ensuring succession as businesses take more risk. Our members, as will other taxpayers, have been encouraged to diversify up the risk scale to remain viable. Renewable enterprises, farm shops, vertical integration, contracting services diversified are good examples of activity that is done to replace poor farming returns. We believe risk taking and investment in diversification would reduce if the test were harder to achieve.

14 The availability of BPR is not generally dependent on the size of a person's interest in a business or holding it for any period after death. Does this feature of BPR add to or reduce complexity?

SLE is concerned by the premise of this question. We see no requirement whatever to limit BPR by the size of a person's interest in a business. This could prohibit a structured and planned handover of a business to successors and would seem to go against the wider policy of context of IHT. It is also unnecessary to impose any minimum holding period after death which in our view would complicate as opposed to simplify the IHT regime.

Farming businesses

15 How, if at all, does the IHT framework, including related tax considerations set out above, make business decisions challenging? Does it affect or distort decisions regarding:

a) whether and when to sell or transfer the farm to another vehicle or to the next generation, or downsize during one's lifetime, or wait until death,

SLE is of the view that the rate of IHT in the UK is particularly high and kicks in at a relatively low value in relation to the value of farm assets, when compared to other countries. Should land need to be sold to meet a tax bill it has to be noted that land is not as readily or frequently traded as other assets and the proximity of the land to the business is, unlike in other spheres of work, of much importance. APR and BPR are therefore both incredibly important to the IHT framework and we do not believe that decisions are distorted regarding selling or transferring land etc. There is normally strong emotional and family attachment to land and farming is a way of life. Decisions are therefore not determined simply by the taxation system, but by a range of motivations. The IHT regime does influence when decisions are made, such as gifting during lifetime, but this is the same with other forms of taxation.

b) the choice for farm owners of letting out farmland versus farming themselves or via a contract farming arrangement,

SLE considers that APR should be tax neutral in land occupation between in hand and let farms. There is a need for flexibility in the let market.

c) the inhabitants and use of the farmhouse,

As set out elsewhere the farmhouse is an integral part of the farming operation. If a farmer had to live off site there would be serious concerns around security and safety. There could also be health and welfare standards concerns about management of livestock.

d) the choice of business vehicle for the farm (for example a corporate entity, partnership, unincorporated business), or

It should be noted that assets held outside of but used by a partnership/company only qualify for BPR at 50%. Landowners may make a conscious choice to keep property outside of the business, rather than introducing it onto the balance sheet. For example, in Scotland, land may be intentionally kept outside of the business due to the Scottish Legal Rights (i.e. forced heirship for moveable property). Once land is introduced into the partnership, the individual will own a partnership interest (moveable asset) instead of an interest in land (immovable asset), and the farm could then be broken up. Tax is therefore a cost that the owner would simply have to accept.

e) the structure of the business (for example, how to diversify or hold non-trading assets)?

Undoubtedly, IHT has a major impact on long range business planning for farms. Farming businesses have become increasingly diversified, but the tax system has not evolved to reflect that diversification. If anything, diversification is disincentivised by tax policy. This sends conflicting signals about the importance of managing volatility in farm businesses. Government should ensure that there is a joined-up approach to achieving its objectives and that policy tools do not send conflicting signals.

Not many pure farming activities are consistently profitable, and some form of diversification is necessary in order to achieve overall profitability for the farming unit. Maximising cashflow for today is important for most business owners, rather than consideration of the IHT implications. Many farming businesses do what they do for commercial purposes with the intention to optimising the use of their assets.

16 Could the criteria for being a farmhouse or the process of determining the agricultural value of the farmhouse be simplified? If so, how?

SLE is of the view that the subjective nature of the 'farmhouse test' creates much uncertainty, albeit case law through court interpretation assists to an extent. An agricultural tie will not automatically qualify for relief, despite the farmhouse being an integral part of the farming operation and providing security for the farm. This can be confusing for lay taxpayers. Determining the 'character' of the farmhouse is for the HMRC technical team after extensive investigation by the district valuer. Experience of members suggests that this can involve protracted correspondence over a long period of time to decide on whether the relief is applicable in a particular case. Challenging any refusal of APR on a farmhouse is time-consuming and costly. There is also anecdotal evidence of entrenched positions being developed in the duration by the district valuer and HMRC. This can be to the significant detriment of the farm, as if APR does not cover the full value of a farmhouse, for those farmers without ability to pay an IHT bill, they will be faced with a decision as to whether to sell the land to pay any tax charge arising on the farmhouse due to the survivor being unlikely to be in a position where they will be able to sacrifice their home. Finally, since APR is on the agricultural value of the farmhouse as opposed to the open market value, this again is subjective and largely dependent upon the district valuer's approach at the time and can be a matter of lengthy negotiation. In Scotland there are many fewer farmhouses where the premium over agricultural value applies. It would be in order for this artificial theoretical approach to be appropriately revisited.

17 What, if any, complexities arise from the fact that BPR and APR overlap, at least in part? Are there discrepancies in the way that they operate? Would it help if APR was replaced by BPR or if the two were merged?

SLE would strongly recommend the continuation of APR and BPR as separate reliefs. Agricultural reliefs have been in existence since the late 19th century when estate duty was introduced and have been in much the same form since 1984 when IHT was introduced. The policy rationale at that time of encouraging enterprise and initiative as stated by the then Chancellor of the Exchequer has been widely acknowledged since. There is in-built confidence in long-term tax planning and the current system has achieved its policy objectives of providing business planning stability, facilitating investment, jobs and innovation.

There are a number of reasons why APR ought to be retained in the current macro-economic climate in particular. We anticipate the probable abolishment of Basic Payments by 2023; we are not clear as to what support will be provided going ahead for productive farming methods; the ongoing uncertainty around the impact of Brexit and particular on producers of commodities such as sheep and pigs; rising interest rates and the impact of weak sterling on imported machinery and inputs; the agricultural productivity gap between the UK and other countries such as Germany and the Netherlands.

Rural businesses have to consider a number of issues such as planning regulations and environmental matters in a different context from urban businesses and it is therefore not always possible for rural businesses to scale up and compete internationally in the same way. It is also important that fiscal policy should dovetail with other government policies emanating for example from DEFRA.

APR has numerous positive advantages to rural businesses. Relief for farms and let land supports the tenanted sector and removal of APR may have the converse effect of making land ownership less available or accessible to both private individuals and community

organisations. Succession planning in business is vital and APR allows for inter-generational family planning to permit viable business to be passed on without disruption. APR can also preserve estates to support historic houses and other heritage property. It also enables smaller scale farms which are valued by society and indeed the strong emotional attachment to these and such demands limit competitiveness and again distinguish rural businesses from urban businesses. APR contributes to the preservation of the countryside and rural economy and without farming many jobs would disappear along with the ability to earn a living in the countryside. Alongside this it needs to be borne in mind that there is clear interaction between economic activity and social and environmental factors.

SLE also observes that there is generally a level playing field in relation to reliefs regardless of the size of the landholding. No reliefs are simply based on acreage, though some will rely on there being sufficient business activity on the land in question to qualify. APR for gardens is restricted unless one can claim character appropriate to the property, but nowhere else is scale relevant, or large better than small.

Underpinning all of the significant points in favour of retention of both APR and BPR is that simplification should not be about merging of reliefs or removal of a relief without proper consideration of the wider policy context.

We would also be concerned if reliefs were to be abolished and merged in order to provide a lower tax rate and/or higher threshold, with the underlying rationale for reduction being forgotten over time and the rate of tax gradually creeping up.

Charitable giving

18 How well do you think the charitable exemption and the lower rate of tax on death is understood by advisers or the public? Please tell us about any areas of complexity in the application of this rate, or the charitable exemption, along with any suggested improvements.

SLE has no comment to make.

Other areas of complexity

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.

SLE has no comment to make.

Wider IHT system

20 Do you think that the IHT system should be reformed more widely to simplify it? If so, how? Should some IHT exemptions be removed to fund a lower or graduated rate or a higher NRB? If so, which ones? Are there any useful lessons that could be learned from other countries? If so what, and from which countries?

IHT already has a reputation as an unfair tax on families that have worked hard to build wealth for the next generation. It is paid at a high rate on assets above a relatively low threshold which has not kept pace with inflation and this can pose real problems for those taxpayers just above the threshold.

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