

TECHNICAL SALES BRIEFING

IHT "BITESIZE" SERIES - PART FOUR RELIEFS FROM INHERITANCE TAX

KEY POINTS

This Technical Sales Briefing:

- › is the fourth in a series covering many aspects of UK Inheritance Tax (IHT). The full content is available on our uTech site
- › deals with the many and varied reliefs from IHT including Business Property Relief (BPR) and Quick Succession Relief

RELIEFS FROM INHERITANCE TAX

There are various reliefs to reduce an individual's exposure to IHT on either lifetime transfers or on the death estate and we will look at many of them in this briefing.

BUSINESS PROPERTY RELIEF

Where 'relevant business property' is transferred the value transferred is reduced by the following percentages for IHT:

IF RELEVANT BUSINESS PROPERTY IS:	REDUCTION IN VALUE
A sole proprietor's business or an interest in partnership	100%
A holding of unquoted shares or shares in a company listed on the Alternative Investments Market	100%
A holding of shares giving control of a public company (i.e. over 50%) either by itself or in conjunction with the related property rules	50%
Land, buildings, machinery or plant owned by a controlling shareholder or by a partner and used wholly or mainly in the business carried on by the company or partnership	50%
Settled property used by a life tenant in his own business	50%



The information is based on Utmost's understanding of current law and HM Revenue and Custom's practice as at 1 July 2021. Tax rules may change and depend on individual circumstances. This information does not constitute legal or tax advice and must not be taken as such. The companies in the Utmost Group can take no responsibility for any loss which may occur as a result of relying on any information in this technical briefing.

PROPERTY NOT ELIGIBLE FOR RELIEF

The relief does not apply to a business or company dealing wholly or mainly in securities, stocks and shares, land or buildings, or making or holding investments, or to a business carried on otherwise than for gain. The value attributable to an **excepted asset** within a business does not qualify. The main excepted assets can include:

- › Property rented to third parties
- › Investments, such as quoted shares, unit trusts, gilts, single premium bonds, etc
- › Large cash balances which are in excess of future business requirements.

Property which is subject to a binding contract for sale will not be eligible for relief. However, when dealing with Partnership/Share Protection Assurance matters, this can often be overcome by using an agreement incorporating a double option to sell (or buy) rather than a binding 'buy and sell' agreement.

OWNERSHIP

Generally business property must have been owned by the transferor for two years before business property relief will be available.

INTERACTION WITH AGRICULTURAL PROPERTY RELIEF

Where the transferor owns agricultural property which is eligible for agricultural property relief, business property relief can only be secured in so far as the property does not qualify for agricultural property relief. Here, if an asset qualifies for both business property and agricultural property relief the agricultural property relief is considered in priority to business property relief.

BUSINESS PROPERTY RELIEF AND LIFETIME GIFTS

Where an individual makes a lifetime gift of business assets, in order for business relief to be available in respect of any tax payable on the transferor's death within seven years of the gift, the transferee must have owned the property (or similarly qualifying property replacing it) until the transferor's death or his own earlier death. Proportionate relief would be available if only a proportion of the property qualified.

AGRICULTURAL PROPERTY RELIEF

HMRC's IHT manuals and s.115 IHTA 1984 detail agricultural relief as follows:

Relief is given on 'agricultural property', such as agricultural land or pasture. It includes woodland and any building used in connection with the intensive rearing of livestock or fish if it is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture. It also includes such cottages, farm buildings and farm houses, together with the land occupied with them, as are of a character appropriate to the property.

It is important to understand that it is the agricultural value of the property that is considered when calculating any relief, not the value that such property may raise on the open market if used for reasons other than agricultural purposes.

The HMRC manuals also state:

The breeding and rearing of horses on a stud farm and the grazing of horses in connection with those activities are treated as 'agriculture' and any buildings used in connection with those activities are treated as farm buildings.

CONDITIONS FOR RELIEF

The relief is available where immediately before the transfer, the transferor either:

- › Has occupied the property for agricultural purposes for at least the previous two years; or
- › Has owned the property (whether it has been occupied by him or another) for the last seven years for the purposes of agriculture.

S130 IHTA 1984 explains that:

Where the transferor became entitled to the property on the death of another person he shall be deemed to have owned the property and, if he subsequently occupies it,

to have occupied it from the date of the death. If it was inherited on the death of a spouse, any period of ownership or occupation will be taken from the date that the deceased spouse had acquired it.

The relief is applied to the value transferred before taking into account any exemptions that may be available. Agricultural property which is subject to a binding contract for sale will not be eligible for agricultural relief.

Where agricultural relief is not available business relief may become available if conditions for that relief are satisfied. The condition regarding ownership of the property by a transferee for business relief also applies for the purposes of agricultural relief.

The value transferred would be reduced by the following percentages:

MEASURE OF RELIEF	REDUCTION IN VALUE
Where the transferor has the right to vacant possession of the property or the right to obtain vacant possession within 12 months	100%
Where the transferor had a beneficial interest in the property before 10 March 1981 and agricultural relief would have been available if he had disposed of it before 10 March 1981 unless the right to vacant possession had been lost since that date by his act or omission to act	100% subject to old limits re: value of £250,000 or 1,000 acres and 50% on the excess over the said limits
Property let subject to an agricultural tenancy commencing after 31 August 1995	100%
Controlling shareholding in a farming company	100% provided that the property has been occupied by the company for two years and also the shareholders owned the shares throughout the relevant period mentioned above.

WOODLANDS

Where on death an estate includes non-agricultural land on which trees or underwood are growing then, subject to certain conditions, the person liable for the tax can elect that the value of trees or underwood is left out of account in determining the value transferred.

Tax is then charged on a subsequent lifetime disposal (other than to a spouse), with or without the land, on the proceeds of sale, or otherwise on the net value of the trees or underwood.

The tax liability falls on the person entitled (or who would be entitled) to the proceeds of sale. Tax will not be charged more than once on the same trees or underwood in respect of the same death.

Business relief may reduce the proceeds or value by 100%.

QUICK SUCCESSION RELIEF (QSR)

Where, within five years of their death, an individual's estate was increased by a chargeable transfer, credit is given against the tax payable on the individual's death for a proportion of tax charged on the earlier transfer. Note here it is important to understand who paid the tax on any chargeable transfer.

Where UK assets are passed on death it is usual that they are paid "tax free"; the actual IHT is paid from the residuary estate. However, the deceased's will can dictate that the tax is borne by the recipient (a tax bearing gift) and here the formula takes into account the tax on the transfer. Foreign assets will also be tax bearing unless the will dictates otherwise. Where CLTs are made that subsequently fail, because the donor has not survived seven years, the calculation will depend on whether the donor paid the tax. To calculate the QSR we use the formula as follows:

$$\text{IHT paid on transfer} \times \text{QSR\%} \times \text{increase in donor's estate due to transfer (net after IHT)} / \text{gross increase plus any IHT paid}$$

The quick succession relief % applicable is then based on the time elapsed as follows:

TIME BETWEEN 1ST TRANSFER AND DEATH	QSR %
Up to 1 year	100%
1-2 years	80%
2-3 years	60%
3-4 years	40%
4-5 years	20%

After five years no quick succession relief is available. There is a similar relief where the chargeable transfer is otherwise than on death in respect of the termination of an interest in possession in a settlement.

EXAMPLE 1

Rod who is UK domiciled dies in 2021/22 leaving, as part of his wider estate, an overseas holiday home to his son Freddy which was worth £200,000. Freddy had to pay IHT on this of 40% or £80,000.

Freddy, widowed, then dies just over two years later and leaves his entire estate of £1,000,000 to his daughter. Freddy has made no previous transfers in the seven years prior to his death and on his wife's death she left her entire estate to Freddy, thus she did not use her NRB. For simplicity we will also assume Freddy has always rented and has never owned a property. The quick succession relief is calculated as follows:

Freddy's death estate	£1,000,000
Less nil rate band	(£650,000) (Freddy's NRB is uplifted for TNRB)
Chargeable estate	£350,000
IHT payable at death rate of 40%	£140,000
QSR = $\frac{£80,000 \times 60\% \times (200,000 - 80,000)}{200,000}$	
QSR is therefore given at	(£28,800)
IHT payable	£111,200

DOUBLE TAXATION

Where double taxation agreements are in place, there is normally provision for relief from double taxation where property is subject to a similar tax abroad.

OTHER RELIEFS AND EXEMPTIONS

Transferable nil rate bands

The personal representatives of a surviving spouse/civil partner who dies on or after 9 October 2007 may claim any unused NRB that existed on the death of the first spouse/civil partner. The claim is based on the proportion of the unused NRB available on the death of the first spouse/civil partner, not the cash amount, therefore effectively 'index linking' the amount that can be transferred.

The rules also allow any unused NRB to be transferred from more than one deceased spouse/civil partner up to a limit of one additional NRB. So if someone has survived more than one spouse/civil partner, then on their death it may be possible to claim unused NRBs from more than one estate. However, the unused NRB accumulated for this purpose is limited to a maximum of the NRB in force at the relevant time (i.e. the survivor's death).

Note if the first death occurred before 12 November 1974 but after 22 March 1972, the spousal exemption was limited to £15,000, so it may not be possible to transfer 100% of the NRB on second death. Much will depend upon the amount that was transferred on first death and whether the exemption was 'unused'. Prior to 22 March 1972 there was no spousal exemption but transferable NRB may still be available depending upon the amount of estate duty used by the first spouse. For deaths on older cases it may be worth discussing the case with HMRC as this can be quite complicated.

Residence nil rate band

From 2017/18, there has been an additional residence nil rate band (RNRB) for transfers on death if the deceased's interest in a residential property which has been their main residence at some point and is included in their estate, is left to one or more direct descendants. The extra amount was £100,000 for 2017/18 and notionally at that level for previous years. It increased to £125,000 in 2018/19 and rises to £150,000 in 2019/20 and £175,000 in 2020/21. It will now remain at £175,000 until and including tax year 2025/26.

Any unused RNRB will be transferable to a surviving spouse or civil partner where the second spouse or civil partner of a couple dies on or after 6 April 2017, irrespective of when the first of the couple died. This is calculated on the same basis as the NRB, based on the percentage amount unused on first death, rather than a cash amount.

The RNRB will be tapered away for estates with a value (disregarding BPR, APR or other reliefs or exemptions) of more than £2 million, by £1 for every £2 that the net value exceeds that amount.

There will also be special provisions where an individual has downsized to a smaller private residence or has ceased to own a private residence on or after 8 July 2015.



A full briefing on the RNRB can be obtained by visiting our uTech site www.utmostinternational.com/wealth-solutions/our-wealth-solutions/united-kingdom/utech.

VOIDABLE TRANSFERS

There are provisions for tax to be reclaimed where a chargeable transfer is set aside by operation of law.

DEEDS OF VARIATION AND DISCLAIMERS

Some or all of the beneficiaries may vary the terms of the deceased's will (or the intestacy provisions) within two years of the person's death. Provided the person(s) varying their interest do not do so for a consideration in money or money's worth, the effect will be to treat the disposition as if made by the deceased. After 1 August 2002, a variation applies automatically for IHT purposes if the individual making the variation specifies that it is to have that effect and a further separate election is not necessary. It is important that when drafting the deed of variation, a statement is made in relation to s142 IHTA 84, that this section is intended to apply. Providing this statement is made, the effect, for IHT purposes, is to effectively rewrite the will as if the deceased had in fact passed their property as indicated in the deed of variation.

A disclaimer of a legacy within two years of the testator's death (other than for a consideration in money or money's worth) is not a transfer of value. There is a similar provision relating to the disclaimer of an interest in settled property.

Property that is subject to a gift with reservation (to the deceased) shall not be capable of being subject to a variation or disclaimer.

Where a trust is created by a deed of variation then, providing a statement in relation to s142 IHTA 84 is made, the trust will be considered for IHT purposes to be settled on death. However, for the purposes of income tax, the settlor will be the person who has made the variation.

PROVISION FOR FAMILY OR DEPENDANTS

Where a court order is made under the Inheritance (Provision for Family and Dependants) Act 1975 (extended by the 2014 Act), which applies to England and Wales, or under the Inheritance (Provision for Family and Dependants) (Northern Ireland) Order 1979, overriding the provisions of a will, intestacy or a disposition made within six years before death, IHT will be charged or refunded as if the order had been made by the deceased.

In Scotland there are also special rules for a person who dies after 12 November 1974 leaving a spouse and a child under 18 entitled to claim (called a legitim). If the person makes provision for the spouse but leaves insufficient to satisfy the entitlement of the legitim (roughly the right to one-third of the moveable property) IHT may be charged at death either on the basis that the claim for legitim was then satisfied or that the disposition to the spouse is not reduced.

At any time before the end of two years after reaching age 18 the child can make or renounce a claim. If he does not renounce before the end of that time he will be assumed to have made a claim. The claim, or renunciation, will be treated as having been made at the deceased's death and tax and interest will be charged, or refunded, accordingly. Where a deferred charge to tax arises as a result of a claim for legitim, tax will become chargeable on the scale of rates applicable at the date of death.

FURTHER UPDATES IN THIS SERIES AND OUR UTECH SITE

The next Technical Sales Briefing in this series will look at trusts and their interaction with IHT.

Note the content in this briefing is taken from our comprehensive Inheritance Tax Manual which is available in the Technical Briefings section of our uTech site (www.utmostinternational.com/wealth-solutions/our-wealth-solutions/united-kingdom/utech/). uTech has several other technical briefings exploring the more niche and complex areas of UK IHT. These include several guides to the Residence Nil Rate Band and a detailed briefing exploring Domicile, Remittance Basis and Excluded Property.

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