All Party Parliamentary Group - Inheritance & Intergenerational Fairness

Interim Recommendations

The All-Party Parliamentary Group for Inheritance & Intergenerational Fairness was established in February 2019 to promote understanding of the issues generated by inheritance and intergenerational fairness and to facilitate discussion on methods of reform.

It is clear that the inheritance tax (IHT) regime raises strong opinions across the political system as well as presenting many individuals with serious concerns due to its perceived unfairness and the huge complexity within which it operates. There is increasing debate about the purpose and effectiveness of inheritance tax particularly in relation to one of the most pressing challenges facing Parliament: Intergenerational Fairness.

Having taken evidence from various stakeholders, the APPG has produced some interim recommendations which are set out below and which will be submitted to the Office of Tax Simplification in relation to simplifying inheritance tax. The recommendations propose a number of ways in which certain aspects of the current inheritance regime could either be removed or altered to remedy the current situation. More radical options are also referred to below which merit further consideration.

1. **Residence nil rate band**

This legislation is very complex. It applies only to those who own or used to own a qualifying residential interest and have lineal descendants. The downsizing conditions are complicated to operate and contain anomalies.

Such individuals will usually require legal advice the cost of which is often disproportionate to the relief being claimed. The unused proportion of the band can be transferred to the surviving spouse but this provision also usually requires legal advice to administer correctly.

**Option:** There is widespread consensus within the industry that the residence nil rate band should be abolished in conjunction with the nil rate band being increased to £500,000 per person. The additional cost of this could be met by tapering the nil rate band away for higher value estates over £2m with the taper perhaps operating to a greater degree than at present to reduce the nil rate band below £325,000 (potentially to zero, although it may be felt that everybody should be left with a minimum nil rate band – perhaps £200,000) on those higher value estates.
This would vastly simplify the relief that the government is trying to provide for home owners. The net cost of this would be the same since most people who would benefit from the £500,000 nil rate band would have at some time owned a residential home and would therefore benefit from downsizing. The only difference is that this relief would be available to those without issue and would not necessitate complicated records linking it to the downsizing provisions.

2. **Exemptions**

2.1. **Spouse**

We propose that the IHT exemption between married and registered civil partners should be retained.

2.2. **Charity**

We propose that the IHT exemption for charities should be retained.

2.3. **Charity Reduced Rate**

IHT can be paid at the reduced rate of 36% if you leave at least 10% of your net estate to charity. However the operation and calculation of the relief is unnecessarily complex.

**Option:** This is not a commonly used or well-known exemption. Unless there is strong evidence to support its use we propose that it is removed from the regime.

2.4. **Annual exemption**

The value of the annual allowance is very outdated at £3,000 per annum. This figure was implemented in 1984 and inflation should have aligned it to approximately £9,500.

**Option 1:** If the annual exemption is retained we propose that threshold is increased to at least £10,000 per person in line with inflation.

**Option 2:** If the annual exemption is retained but other exemptions such as normal expenditure out of income and gifts in consideration of marriage are removed the annual exemption should be increased to £30,000 per person.

2.5 **Small gifts**
The value of this allowance is also very outdated at the fixed figure of £250 since 1984. The aim of this relief is to ensure that practitioners do not need to investigate every small gift in the 7 years prior to death and work out if together these all exceed the annual exemption and therefore use up the nil rate band.

Option 1: We propose that the small gifts exemption should be increased to £500 for inflation and compliance purposes.

Option 2: If the annual exemption is increased sufficiently (2.4) then the small gifts exemption could arguably be removed but we would suggest it is at present retained so that executors do not need to add up tiny gifts.

2.6 Gifts in consideration of marriage

Option: We propose that this exemption should be removed. There is a lack of awareness around it and the increase of the annual exemption (2.4) could cover any gifts in consideration of marriage.

2.7 Normal expenditure out of income

Option: We propose that normal expenditure out of income relief should be retained because it is reasonably well known and regularly used.

3. Key reliefs

3.1 AIM Shares

Option: BPR for Aim shares in trading companies is seen by many as anomalous as such shares can be sold on the market and thus funds raised to pay the IHT, while this option is not easily available for family companies. Having said that it may be seen as desirable to encourage equity investment in higher risk ventures and investment in such shares already receive CGT and income tax incentives. We suggest that BPR relief in AIM companies is separately examined to see if it is delivering value for money for taxpayers and whether the conditions for AIM investment should be modified or made more restrictive than for family companies e.g. to cover higher risk investments or whether BPR on AIM investments should simply be abolished.

3.2 Forestry

We propose that reliefs for forestry should be retained to encourage woodland development.
3.3 Agricultural Property Relief

The general industry consensus is that the APR regime is important for working farmers and their families and it works efficiently although there are some difficulties in practice due to its complex provisions.

**Option:** Both in relation to BPR and APR (see below) there should be no CGT uplift on death to the extent that such property qualifies for full exemption from inheritance tax on death. The position where partial relief is available would need to be considered.

3.4 Business Property Relief

The general industry consensus is that BPR is crucial for the support of the family business sector and it is generally well understood by business owners. It also incentivises younger family members to become involved in the family business and become invested in its success. However, there was agreement that the legislation could be clarified in some areas and that the rules are not sufficiently aligned between lifetime giving and the position on death.

**Option:** To the extent that the business has qualified for BPR on death then the CGT tax free uplift should not be available. There would be a no gain no loss transfer on death and the gain would then be taxed on a later sale of the business by the heirs (or executors). This would better align the position between lifetime and death transfers of wealth and also ensure that if there was a sale by the family soon after the death, CGT would still be paid. At present it is possible for the business to be exempt from IHT on death and sold immediately thereafter with no CGT payable and the heirs walk away with tax free cash. This does not seem to justify the policy aim of encouraging the retention of family businesses.

Rather than building in artificial minimum periods during which the business has to be retained after death to qualify for BPR (as occurs in Ireland and Germany) we think it is better to align the tax position with lifetime gifts and simply defer the gain until an actual disposal occurs after death.

4. Potentially Exempt Transfers

There are some common misconceptions amongst taxpayers as to how taper relief for PETs should be applied and these difficulties are increased when the nil rate band is added to this mix. The seven year timeframe requires meticulous record keeping by the donor. It can be onerous to locate these records and it is a serious problem when acting as an executor. The PET regime needs to be simplified in order to facilitate compliance, public understanding and to incentivise intergenerational giving.
**Option 1:** The seven year period should be reduced to 5 years and taper relief should be abolished. Provided that a higher annual exemption is offered of say £40,000 to enable small trusts to continue the nil rate band could be allocated only against the death estate. The annual exemption could then be pro rated between all lifetime gifts made in the same year with the donee remaining primarily liable for any additional IHT in the event that the donor died within 7 years.

**Option 2:** If a donor gifts property or cash during their lifetime over the (higher) annual exemption then they will be required to pay 10% IHT immediately withheld from cash gifts at source and payable on the value of non-cash gifts that are illiquid in instalments if so desired. If the donor survives a year no further IHT is payable. The rates would be higher on the death estate.

A 10 per cent one off charge on all lifetime gifts to individuals and trusts would level the playing field and ensure that some revenue is actually collected on lifetime gifts. All lifetime gifts should be reported over the annual exemption with the form being a simple online form that can be downloaded or submitted electronically. This would also assist in developing policy by giving better information

**Option 3:** As an alternative to Option 2 the donor could make the choice whether to pay the 10% IHT immediately on the gift of property or cash or choose to apply the existing PET rules so that after 7 years the gift would become exempt from IHT.

**Option 4:** Gifts to younger people should have beneficial treatment provided the capital was ring fenced for certain purposes similar to a child trust fund.

**Option 5:** Gifts to trusts should be taxed on the same basis as gifts to individuals (i.e. as potentially exempt transfers). The trust assets would need to form part of the estate of one or more beneficiaries. This would encourage earlier giving to future generations. The existing 20% entry charge for trusts is rarely paid and effectively therefore is a dead letter.

**5. Rates & Nil Rate Band**

The nil rate band has been frozen at £325,000 since 2009 and the standard IHT rate is a flat rate of 40% in excess of £325,000. The interaction between the nil rate band and the IHT rate is critical; therefore they have been reviewed in alignment.

**Option 1:** The residence nil rate band should be abolished in conjunction with the nil rate band being increased to £500,000 per person which tapers away for higher value estates. In this scenario the IHT rate could be retained at 40%. See above conditions.
Option 2: The IHT rate should be reduced to a flat rate of 20% in conjunction with a reduction of the nil rate band.

6. Deeds of Variation

There is general agreement amongst industry experts that Deeds of Variation are a useful tool to correct badly drafted wills by the ill-advised or those who have died intestate and should be retained.

Option: We propose that Deeds of Variation in their current format are retained.

7. IHT Collection

The deadline for payment of IHT is 6 months after death whilst the deadline for submitting the IHT paperwork is 12 months. These time limits need to be reviewed in accordance with the time available for HMRC to raise an enquiry where a return has been submitted. Section 240 IHTA ‘Underpayments’ is also inadequate and very unclear.

Option: The deadline for payment of IHT should be extended to 12 months and the liability provisions reviewed so that clarity is obtained on the time limits within which HMRC can raise enquiries and issue notices of determination.