Think Ahead ACCA

Technical factsheet

Inheritance tax planning

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INTRODUCTION

The first taxes on the value of a person's estate passing at the date of death were created in 1894 in the form of a type of stamp duty on the legal document which passed ownership. These duties were eventually abolished and consolidated into one tax that applied to the estate at the date of death, but even today it is quite common for the expression 'death duties' to be used to describe inheritance tax (IHT).

Estate duty was the principal tax levied on the value of estates and it soon became clear that, by a deathbed transfer of assets in lifetime by a dying person, the liability could be easily avoided.

This led to gifts during lifetime being identified and, at that time, added to the value of the estate at the date of death – originally over a four-year period, it was eventually extended to seven years. The rates of estate duty started at 25% and escalated on larger estates to 75%.

This was replaced by capital transfer tax in the mid-1970s, with the intention that all capital transfers made during lifetime and death should be chargeable on a cumulative basis. Under this regime there was a positive encouragement to make lifetime gifts because the tax on such gifts was only 50% of the rate that applied at the date of death.

During the 1980s the then Conservative government made a number of reforms to the principles of this tax so that it would only apply to the estate at the date of death and to transfers made within seven years of death. Gifts made during lifetime would not be charged at all if the donor lived for at least seven years. However, instead of adding the lifetime gifts to the value of the estate at the death –as happened under estate duty – each lifetime gift within seven years of death was individually chargeable in chronological sequence. This was considered to be a sufficiently different principle of charging the estate so it was decided in 1986 to rename it, and from that date forwards it became known as inheritance tax. There had been a consolidating statute in 1984 – the Capital Transfer Tax Act 1984 – and this was renamed the Inheritance Tax Act 1984 (IHTA84), even though that tax did not apply until the reform in 1986!

Under this system, most gifts made during lifetime would be regarded initially as potentially exempt transfers or PETs. They would only become chargeable transfers if death occurred within seven years. However, if there had been a chargeable lifetime transfer in the seven years before the PET that became chargeable, this would have used up part of the available nil-rate band, and so could increase the liability on that transfer.

Certain transfers remained chargeable during lifetime outside of this seven-year period although the liability on such lifetime transfers was still 50% of the rate that applied at the date of death. As the new IHT charged at a flat rate of 40% where the chargeable transfer exceeded the nil-rate band this meant that the liability on such a lifetime transfer was 20%. However, if death occurred within seven years, these transfers were recharged at the death rate, exposing them to an additional liability.

The categories of chargeable lifetime transfers were:

- Gratuitous Transfers to a company unless 100% business property relief was available – this would normally be the case but incorporation of an activity that does not qualify at the 100% could trigger a liability
- Gratuitous Transfers by a close company unless it was taxed as a benefit in kind in the hands of the directors, which in most cases would be the case. These transfers where chargeable were apportioned between the shareholders in the proportion in which they shared profits minus any benefit they received.
- Transfers to a settlement – originally only Discretionary Trusts but in 2006 this was extended to the majority of trusts created during lifetime.

During the past 10 years, the tax has become more complex because of the introduction of a transferable element to the nil-rate band if a spouse did not use it in full, and then the creation of an additional transferable nil-rate band where part of the estate consisted of residential property occupied as a residence or assets derived from the disposal of such a residential property.

The fundamental problem is that planning for a tax which can levied over such a long period – although the chargeable period is seven years before the date of death an earlier chargeable lifetime transfer might need to be taken into account for the seven years before that, up to 14 years – is not straightforward and actions taken now might be regretted in years to come, as we shall see. However, given the number of reliefs that are available, making full use of them is always the most secure way of planning to mitigate the liability that might arise.

WHO IS VULNERABLE?

Unlike income tax, where planning could be a fairly continuous process of review of a client's affairs, or capital gains tax (CGT), where, ideally, planning could take place before a disposal is contemplated (if only that always happened in practice!) IHT is something that clients will prefer not to think about until a fairly momentous stage in their life – marriage perhaps, birth of a child maybe, but increasingly as they get older. However, concentrating on older clients is a mistake.

The first question a practitioner should ask is: which of my clients is most vulnerable? Which will be impacted to the greatest extent by an unwelcome IHT liability should it arise?

It is not the elderly – true, the older they are the more likely it becomes that they will die and so trigger a liability, but normally they do not pay it – it is their beneficiaries who will bear the burden of liability. However, one group of elderly people may be impacted and that is carers: two elderly sisters living together will be badly affected when the first dies as there is no spouse exemption in this situation. If the estate exceeds the nil-rate band, there will be a liability.

The MOST vulnerable group are actually the young – especially if living together (more and more people cohabit outside of marriage or civil partnership) and even more so if they have children. When you add in the statistic that most will die intestate, it becomes clear that this group, should a liability arise, will be in a potentially impossible situation.

Planning for this group will usually be to advocate marriage(!) but to also consider insurance and writing a will. If a liability arises, the insurance policy will meet the potential sum due and pay directly to the other party so that it does not become part of the estate of the deceased. Writing a will ensures that the harsh impact of the intestacy provisions do not apply.

Example:

Mary and Michael have lived together for the last 10 years and have two children aged four and six. They jointly bought a house worth approximately £500,000 and have a mortgage protection policy to ensure that if either of them dies the mortgage will be paid off.

Michael has a small portfolio of investments he inherited from his mother eight years ago and this is worth £120,000. He has a death-in-service benefit which is four times his current salary, which is £60,000. When he joined the company he was asked if he wanted to nominate this benefit but he didn't bother. His share of furniture and personal effects amounts to £15,000. Michael and Mary haven't bothered to make wills.

Michael is killed in a tragic car accident – what happens now?

Mary, as survivor, will inherit Michael's half of the house under the principal of joint ownership provided that they had not decided to own the house as Tenants in Common. In Scotland, the law is different and so we will assume that they bought the property with a survivorship clause.

Michael's estate will be determined for IHT purposes as follows:

His half of the **house**: as this passes to someone who is not his wife but a survivor, this will usually be subject to a discount of approximately 10% – hence £225,000. There are the **investments** (£120,000); the death-in-service benefit (£240,000) and his share of **furniture and personal effects** (£15,000) – a total of £600,000. Against this can be set the nil-rate band of £325,000, leaving £275,000 within the charge to IHT and a liability at 40% of £110,000. Who pays it?

Mary, as survivor, must pay the tax on the share of the house passing to her: this will be 225/600ths of £110,000, a very unwelcome tax demand of £41,250, which she may well find difficulty paying. She can elect to spread this over 10 years and will incur the current HMRC interest rate of 2.6%, but this is of little assistance.

As they were not married, Mary is not entitled to anything else as of right; the rest of Michael's estate will be held under statutory trust for the children until they reach the age of 18 but the trustees will have to find the balance of the liability of £68,750 and this cannot be spread.

Under English and Welsh law, Mary could make a claim under the Inheritance (Provision for Family and Dependents) Act 1975 for a reasonable award out the estate. She must make this claim within six months. In Scotland the law recognises the status of a cohabiting person, but this does not carry any rights beyond the court awarding a sum out of the net estate.

It could be worse

Under the intestacy provisions, priority is always given to a spouse even if they no longer live with the deceased. Under the law that applies in England and Wales, the estate of a deceased person who dies without leaving a will is divided as follows:

- Spouse (marriage or civil partnership) but no children – in this case the spouse inherits the whole of the estate.
- Spouse and children of the deceased – here, the spouse is entitled to a statutory legacy of £250,000, the personal chattels of the deceased and interest from the date of death. The residue of the estate is then divided. The spouse takes 50% absolutely and the remainder of the estate is divided equally between the children and held on statutory trusts until they reach the age of 18.
- No surviving spouse – it is necessary to consider the following categories of

relatives. If anyone survives in a particular class then it has the effect of excluding all of the following classes. In the case of certain relatives if they die leaving children, those children will take the share that would otherwise have gone to their parent – the principle of *per stirpes*

- children and remoter issue
- parents
- brother and sisters of the whole blood (two parents in common) and remoter issue
- brothers and sisters of the half-blood (one parent in common) and remoter issue
- grandparents
- aunts and uncles of the whole blood and remoter issue
- aunts and uncles of the half blood and remoter issue.

Remoter relatives have no entitlement in England and Wales.

The law in Scotland is different: spouses and children have prior and legal rights that may need to be taken into account, and more remote relatives can inherit, leading lawyers to have to search for remote survivors. In England and Wales, if there are no closer relatives than first cousins, then the balance of the estate passes 'bona vacantia' to the Crown or in Cornwall the Duchy.

Ownership of property

In English and Welsh property law, there are two ways in which real property, land and buildings can be owned. This makes an enormous different to the position, as we saw in the example concerning Michael and Mary above.

- Joint ownership – this is a form of trust and governed by trust law. It is a trust with no trustees other than the joint owners themselves. The most important aspect of joint ownership is that on death the share of the deceased passes automatically to the survivor outside of the estate of the deceased. For IHT purposes it is aggregated, with the value of the remaining 'free estate':

property that can be left in the will of the deceased. An appropriate fraction of the IHT liability on death must be borne by the survivor and paid, or paid by instalments over 10 years.

- Tenants in common – this is direct and independent ownership of a share of the asset in question which could be sold without the consent of the other party. As such, it is part of free estate and so can be left in the will of the deceased to anyone that they choose. Where the tenants are spouses, the related property rule applies and the property value is divided in the ratio in which they acknowledge ownership which can, by agreement, be any ratio they choose. Where they are not spouses, the valuation is normally discounted, usually by around 10%, although this could be negotiated with the Valuation Office Agency (VOA): an executive branch of HMRC acting as valuers.

Wills

There are rules concerning validity of wills and the bequests they contain, which can become very complex. Accountants should never consider themselves competent to draw up a will: this should always be left to the legal profession, and ideally those competent to do so. It should be borne in mind that marriage negates all earlier wills unless drawn up in specific contemplation of that marriage to that person.

Deeds of variation

Wills can be varied by the parties subsequently and this can be a very useful form of planning. A variation can be made of a will or indeed an intestacy and, where it is executed within two years, can also be regarded for IHT and CGT purposes as being effective where the document contains a declaration to that effect.

It is possible execute a deed of variation that varies the ownership of property. This means it can be used to break joint tenancy and substitute tenancy in common, enabling property that would otherwise pass automatically to the survivor to be passed to other beneficiaries, therefore allowing reliefs or exemptions to be claimed.

To be legally valid it requires the consent of ALL of the beneficiaries involved. Where children under the age of 18 are involved, it will require using the Family Court to authorise the variation on their behalf.

It is an established principle that seeking a deed of variation, while not greatly liked by HMRC, is not avoidance of liability.

Domicile

Domicile is the determination of the legal system that applies to the estate of a person at the date of their death, and governs the competency of their ability to make gifts and enter into contracts. Domicile of origin is acquired from a person's parents, while domicile of choice is established by conduct in later years; some people may have a domicile of dependency.

Usually thought of as the place where a person would intend to return to die, it should be noted that for taxation purposes and especially IHT, there is deemed domicile where a person had been resident in the UK for 15 out of the previous 20 tax years. It also applies if a person domiciled in the UK at the time of their birth was resident in any year from 2017/18 onwards.

It is possible for a person to have a legal domicile which is not the same as their taxation domicile.

IHT used to follow legal domicile and a person domiciled in the UK is liable on all of their property wherever it is situated in the world although Double Taxation Relief can be claimed if also chargeable elsewhere. A person who is not domiciled is normally only liable on their UK property.

Where a non-domiciled person 'owns' residential property in the UK through an envelope such as an offshore company, it is now possible for this property to be treated as though chargeable in respect of that person. If they owned it directly, it would be UK within the charge to IHT in any event.

The rule applies where a company used to own the property is a company that would be a close company if it was UK resident.

Where a person who is not (or not yet) domiciled in the UK establishes an offshore settlement, this will constitute a category of excluded property unless it includes residential property. Sums added subsequently, following a person becoming UK domiciled, can no longer be treated as excluded and so will be exposed to liability.

Once upon a time there used to be a roaring trade in these trusts as they constituted excluded property, but where they are acquired for money or money's worth, they are no longer excluded property as far as a UK-domiciled or deemed domiciled beneficiary is concerned.

BASIC PRINCIPLES

IHT is chargeable on a **transfer of value** – an event that causes the estate of the donor to be diminished. This will often be a gift but could also be a deliberate sale of an asset at undervalue. The value is NOT the value of the asset that is gifted; it is the amount by which the value of the estate of the donor is reduced.

This can be especially significant where a transfer of shares impacts on the degree of control of a shareholder.

A owns 90% of the shares of a company. This gives virtual total control as they can compel the other shareholders to sell their shares to them. If he gives 20% of his holding to his brother, who owns the other 10% of the shares, the brother will have 30% of the shares with the right to call extraordinary meetings – quite a considerable degree of interference.

The chargeable value is not the value of the 20% shares given to the brother; that would be the value for CGT purposes – the value of the asset disposed of. It is the difference between the 90% holding that he enjoyed before the transfer and the value of the 70% holding which remains after the chargeable transfer is made.

Related property transactions

Where property is jointly owned and transferred between spouses, the value is determined by aggregating the value of the shares owned.

> **Example**
>
> B owns 90% of the shares in a company where the remaining 10% is owned by his spouse. He gives 20% of the shares to his son.
>
> The shares owned by the spouse must be aggregated with B's holding, so the value of the transfer is going to be the difference between a 100% holding and an 80% interest in the company, adding the related property 10% to his own holding.
>
> If B were to die, the value of his remaining 70% holding would be 70/80ths of the value of an 80% holding.
>
> Where related property is sold at a loss after the date of death, it is possible to elect to revalue it as unrelated property but this might affect the availability of other reliefs.
>
> C owns 40% of the shares in a company and his spouse owns 20%. The related holding is 40/60ths of a 60% shareholding. The 40% shareholding is then sold at a loss. The company as related property gave control, and so an entitlement to 50% business property relief exists on assets owned individually and used in the trade. If it is revalued as an unrelated holding, it will not possess control and that 50% BPR will no longer be given.

The principle of related property also applies where property is jointly owned with a charity or a political party as a result of a prior gift.

Potentially exempt transfers (PETs)

It is tempting for taxpayers to ignore gifts made during lifetime as no immediate liability follows. It clearly makes sense, however, to keep records of gifts made so that in the event of death occurring, perhaps unexpectedly, the executors will be able to identify the earlier PETs, which become chargeable as a result of death having occurred.

Where a transfer of value is less than the available exemptions, it is not superficially a PET, but care needs to be taken with the nil-rate band, which is not an exemption.

If there had been a chargeable transfer in the seven years before the PET, that would use part of the nil-rate band, which would not then be available on the later transfer.

In determining liability, PETs and chargeable transfers if they exist are dealt with in strict chronological order – only transfers made on the same day are considered to share exemptions where relevant and the nil-rate band. The liability where a PET becomes chargeable is primarily that of the donee, not the estate. It is possible for a donor to provide that the estate pays the IHT on a PET, but the primary liability is still that of the done. If the estate is insufficient, it is still the donee to whom HMRC will turn.

Again, insurance can be used to guard against the liability that might arise on a PET. Usually, this will be quite reasonable as it is only necessary to insure for a maximum of seven years. In the later years, the liability arising is reduced by taper relief.

Taper relief

Where more than three years elapses between the date of death and an earlier chargeable transfer or a PET that becomes chargeable, taper relief is given to reduce the tax actually payable. Within four years it is 20%; within five, 40%; within six, 60%; within seven, 80%; and obviously after seven years, effectively 100%.

Chargeable lifetime transfer additional liability

Because transfers are dealt with in strict chronological order, care needs to be taken with the sequence in which gifts are made.

A decides to establish a lifetime settlement for the benefit of his sister and transfers £200,000 to trustees – well within the nil-rate band.

He dies four years later and his executor realises that he made a PET to his son of £200,000 in the year before the creation of the lifetime settlement.

Dealing with each transfer chronologically means that the PET, which now becomes chargeable, attracts an annual allowance of £6,000 and so uses £194,000 of the nil-rate band. The settlement has an annual allowance of £3,000 and so £197,000 becomes chargeable. The nil-rate band of £325,000 is reduced by the £194,000 used against the PET and so £131,000 remains. The settlement now has a liability of 40% (within seven years of death) of £66,000, which is £26,400, and after taper relief of 20% leaves a liability of £21,120.

Again, the settlement can take out insurance to protect against this possible liability.

Insurance

Under the law in England and Wales, a person has an insurable interest and so can take out an insurance policy on their own life or that of a spouse – and this is unlimited. A policy can also be taken out on the life of any other person IF, AND ONLY IF, you stand to suffer financially as a result of their death – but the maximum sum that may be insured is equal to the maximum loss that you might potentially suffer – the IHT liability assuming death within three years.

SPOUSE EXEMPTION

Of the exemptions and reliefs available, this is for most people the most important but, of course, only if they are married or have entered into a ceremony of civil marriage. It extends to persons who are recognised as married under the law of another country.

One current danger is that many Islamic marriages are being contracted without the parties entering into a form of marriage recognised in law. This also applies to persons marrying under the rites of the Roman Catholic church. Unless they go through a civil ceremony recognised in law or the priest is also authorised to register a marriage, they will not be married for this purpose. Ministers of the Jewish and Quaker denominations are automatically authorised. Roman Catholics are used to this form of discrimination and will usually have a registrar present in the church to carry out the civil aspect of the ceremony after the religious ceremony has been conducted if the priest is not authorised.

It seems that many Islamic marriages are being entered into under sharia law, which may not enjoy the protection of law and, for IHT purposes, the spouse exemption. This was confirmed in a Court of Appeal decision reported in February 2020 and while the case was concerned with the ability of a party to a marriage in the Islamic nikah form to seek a divorce in civil law in the UK, the court concluded that without marriage registration, the ceremony was not a marriage at all. The consequences for IHT are considerable and would almost certainly deny the availability of the spouse exemption and related reliefs.

Non-domiciled spouses

Where a spouse is not domiciled in the UK, the exemption is not limitless as it would normally be. The exemption is limited to an amount equal to the nil-rate band and where the property passing to the spouse exceeds that figure a liability will arise.

However, it is possible for the non-domiciled spouse to elect to be treated as domiciled in the UK, permitting the full unlimited exemption to be given, but this will be effective for all taxation purposes. A person not domiciled in the UK is only chargeable to IHT on their property situated legally in the UK, so by electing to be treated as UK domiciled for the purpose of obtaining the spouse exemption, their offshore property becomes chargeable in the UK.

UTILISING EXEMPTIONS AND RELIEFS

Over a number of years, by using the available exemptions and reliefs, it will be possible for significant sums to be transferred to successive generations with no danger of an IHT liability.

Because the basic charging point is death and the previous seven years, it means that as every seven years passes, an amount equal to the nil-rate band can be transferred without liability. A male aged 50 can currently expect to live to the age of 84 with a one in four chance of living to 93 and a one in 10 chance of living to 97, according to the Office of National Statistics. Over 34 years to age 84, amounts of up to five times the nil-rate band could be transferred: over £1.5m!

There are a number of exemptions and reliefs that can increase the amount that can be transferred significantly, but they have been frozen since the 1980s – some since before estate duty was abolished in 1974 – and so their value has been eroded significantly:

- small gifts – £250 per annum per donee; useful for Christmas and birthday gifts
- annual exemption – £3,000 but if not used in full, the excess can be carried forward and added to the exemption of the following year
- gifts out of normal income – the most useful. Before 1986, the tax was called capital transfer tax, so a gift out of income could not be chargeable. The gift must be cash, or an asset purchased with cash. Such gifts must be habitual (the first gift could be habitual if there was evidence of intent to be habitual) and the donor must be left with sufficient income to meet their normal standard of living and pay their tax liability. Anyone planning to use this exemption should keep annual records as HMRC will expect the personal representative to complete a schedule for the seven years up to the date of

death showing income, expenditure, tax due and gifts made. A deed of covenant is a legally binding gift of income and can be useful to establish habitual intent.

- gifts on occasion of marriage – the gift must be in contemplation of a marriage between identifiable persons not just a vague intent.
  - parents £5,000 each
  - grandparents £2,500 each
  - bride and groom £2,500 each
  - everybody else £1,000 each
- The nil-rate band – £325,000. This is not an exemption, but it is a significant relief and effectively becomes refreshed every seven years. However, because it is applied against chargeable transfers in chronological sequence, it makes it very difficult to gift equivalent amounts to beneficiaries, as early gifts will either not be chargeable at all or will use the available nil-rate band so that it is only partly available on the later transfer.

Example

Suppose David, who is a widower, aged 47, has won a significant sum on the lottery and wants to make substantial gifts to his two children, a son aged 24 and a daughter aged 19. The 24-year-old is about to get married and so David wants to give him £500,000! There will be exemptions, of course: the marriage exemption, the annual exemption for that year and the year before if that was not used, a total of £11,000. This leaves a potentially exempt transfer of £489,000 and so no immediate liability.

What about the 19-year-old? In due course, David will probably want to give her a similar sum but she is too young to receive such a gift now. If he gives her a similar sum in, say, three years, we have a problem. If David dies within seven years of the first gift to the son, it will, as we have seen, be exempt. But the later gift to the daughter will not benefit from any more than the residue of the available nil-rate band because it is applied chronologically against chargeable transfers in the seven years before death.

Because of this, it becomes very difficult to ensure that children receive gifts of equal or equivalent value from lifetime transfers.

A solution before 2006 would be to gift an amount to the daughter using a trust at the same time and amount as the gift to the son, with the capital to be transferred to the daughter at a later stage. This used to be treated as a PET as long as the trust was not discretionary, but in 2006 this became a chargeable lifetime transfer incurring an immediate 20% liability where chargeable, and subject to a further charge every 10 years.

A further significant aspect of this for spouses is that the amount unused in the final analysis can increase the amount available to a surviving spouse on that spouse's death. This works by identifying the amount that is unused as a proportion of the total available and then increasing the amount available to a surviving spouse by a corresponding amount.

Exempt transfers

These are transfers that are not chargeable to IHT, even though such a transfer might reduce the value of the donor's estate:

- transfers to a charity or community amateur sports club
- transfers to a recognised political party
- transfers where there is no gratuitous intent (IHTA84/10)
- transfers for family maintenance (IHTA84/11)
- transfers to provide a pension.

There is no limit to the amount of the *charity or political party exemption*, provided that the donee will apply the sum to their purpose or invest to protect future position. Where at least 10% of the estate is left to charity, the rate on the remaining estate from which the gift is made can be reduced to 36%.

Transfers without gratuitous intent would include the unwitting sale of an asset at undervalue or a burglary if you were not insured. It causes the value of the estate to be diminished but is not intended to confer a benefit on the beneficiary.

Transfers for family maintenance usually occur where a capital sum is being used to secure the maintenance of the other party to a marriage or a child on divorce or separation. This can be a silver lining to a very dark cloud as it allows settlements for the family to be created without immediate liability or exposure to the 10-year charge.

With *transfers for pension purposes*, there can be a danger if such a transfer is made within two years of the date of death. As a result of the recent Staveley case, this is being reconsidered by HMRC.

Excluded property

Property owned outside the UK by a non-domiciled person are:

- Assets of national, artistic, scientific or historic interest. HMRC maintains a register of these and provided certain conditions are observed – including public access – these can be excluded from a current IHT calculation. If sold at a later date, they become chargeable by reference to the value of the largest estate they passed through. They must also be maintained and insured, and the beneficiary to whom they are left must accept the various undertakings.
- Reversionary interests. Unless purchased for money or monies' worth, the interest that a person has following the death of the last life tenant or charitable object is excluded property and can be gifted without liability. This can be useful to allow wealth to be redirected to younger generations.

Others include:

- UK government securities owned by non-residents (Free Of Tax for Residents Abroad – FOTRA)
- National savings interests on the Channel Islands and the Isle of Man.

Reliefs

Business property relief (BPR)

There are two rates of BPR: 100% relief and 50% relief.

100% relief is available where an asset is owned for at least two years and is available for lifetime transfers as well as the asset at the date of death. It extends to interests in a business as a sole trader or partner where the assets are used in a business where the level of activity is such that it is not the holding or making of investments. Furnished holiday lettings, deemed to be a trade for income tax and CGT purposes, will rarely involve activity sufficient to be treated as a trade in its own right.

It is also available for any holding of shares in an unlisted company, provided that it does not carry on a business of holding or making investments. This extends to shares quoted on the AIM, which can be a useful component of a portfolio despite the added risk that they may present in the long term.

50% relief is available for holdings in quoted companies which give control even where the related property rules apply. It is also available for assets owned individually but used in a trade which the individual controls. Assets may be better owned inside a company where 100% relief would be given on the value of the shares which the assets represent. 50% relief extends to assets owned individually but used in a trade carried on by a partnership in which the person is an active member.

Agricultural property relief (APR)

Available in most cases at 100%, it can be claimed after two years if occupied as that person's farm or after seven years where owned and let to another for agricultural purposes. This can be a working farm in the UK, the Channel Islands, the Isle of Man or the European Economic Area. Having left the EU, the UK is now no longer a member of either the EU or the EEA, and it remains to be seen later this year whether consequences will flow from this for APR purposes.

BPR is restricted to the agricultural value of the land, which may be less than the open-market value. If it is the person's own farm, the excess value may attract BPR as well and so be effectively completely exempt.

The value of farm buildings qualifies as well, and this extends to the farmhouse, provided that it is appropriate for the size of the farm. This is normally established by comparison with other neighbouring properties.

Estate disposal reliefs

These are not relevant from a planning point of view but do help estates where values go down after the date of death and assets are sold at a loss by reference to probate value. Where claimed, the CGT loss available is reduced by the amount set off against the value of the estate:

- property – where sold within four years of the date of death
- quoted shares – where sold within one year of the date of death
- related property – where sold for less than related property value, although if claimed and it leads to a loss of control, this may impact the other reliefs described above.

DANGERS IN PLANNING

Taxpayers can utilise the various reliefs outlined above without any danger provided that the various actions are genuine. Transfers to a spouse to allow the spouse to also take advantage of the exemptions can effectively double their value provided they are not conditional, but they must not be regarded as an associated operation.

Associated operations are transactions that are linked to another so that they effect a transfer at a value that is reduced when compared with its true value. They may take place at different times or involve a number of steps at the same time; they do not necessarily need to be made by the same person and may be an omission to carry out something (such as not taking up rights).

Where transactions are associated, they are all regarded as taking place at the date of the last transaction.

For example, A may grant a tenancy to B, which reduces the value of the freehold interest and then two years later gifts the freehold reversion to the tenant at a time when the value of the property has increased but the value of the freehold is still reduced by the existence of the tenancy. The effect of the two transactions is to transfer the original freehold in two stages but at a significantly lower value.

If treated as an associated operation, the transfer would be treated as made at the date of the later transfer and the value would be the reduction in value of the estate at that point equal to the unencumbered freehold value.

A gift with reservation of benefit (GWROB) occurs where a person gifts the legal ownership of an asset but continues to make use of the asset in question. Where there is a GWROB there can be unfortunate consequences as the gift is legally effective when made – a PET – but the asset continues to be treated as in the estate of the transferor. If use is relinquished subsequently, this would also be a PET. Sudden death could cause both to be chargeable. If use is not relinquished, the asset would remain part of the estate of the transferor for IHT purposes. There is a double charge relief so that if both occur, only the transfer giving the larger overall liability is charged.

In recent years, a type of scheme became popular which claimed to enable tax effective transfers of the property in which a person resided to another while permitting the transferor to continue to live in the property without reservation of benefit.

These schemes became less attractive in 2003, with the creation of an income tax charge called the pre-owned asset tax (POAT). This treated the market value of the use of the asset as an income tax benefit and could have exceeded the amount of the IHT potentially saved.

It involved the sale of the residence to a first trust for full consideration, which is left outstanding as a loan. The loan is securitised as a loan note held by the transferor. A second trust is then established to hold the loan note, which has the effect of reducing the value of the property held in trust #1 to zero because of the loan note and placing the value of the property in trust #2 for the benefit of the beneficiaries.

In a very recent case – called the Herbert case (Shelford v HMRC) – the scheme failed because there had been an attempt to avoid stamp duty as well by not completing the transfer of the property into trust #1. This is not possible following the introduction of stamp duty land tax. The effect was that the transfer had not been genuinely made and so the value of estate had not left the estate of the donor, Mr Herbert. However, the value of the equitable interest was still inside the trust but the conditions for the double charge relief were not satisfied. To make matters worse, the individual had paid substantial sums of income tax under the POAT scheme which the judge said were not due as the asset had never been transferred in law to the trust. However, the judge expressed the opinion that whether the POAT could be refunded was up to HMRC. It is most unlikely that they would refund these sums which had been paid more than four years before the decision!

The judge expressed his opinion of the scheme in the following words:
"This serves as a warning that the implementation of tax avoidance schemes can sometimes have the consequence of the participants paying more tax than if they had done nothing: if you play with fire do not be surprised if your fingers are burnt."

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