

INHERITANCE TAX PROPOSED CHANGES: SECOND OFFICE OF TAX SIMPLIFICATION REPORT



The Office of Tax Simplification (OTS) has completed its review of a wide range of administrative and technical aspects of inheritance tax (IHT). It published its [first report](#) (on administration of the tax) in November 2018, and on 8 July 2019 it published its [second report](#), on the main complexities and technical issues that arise from the way the tax works.

While the OTS can only recommend changes to the Chancellor, the IHT rules are outdated, complex, and seen by many as ripe for reform. Therefore, it is important that individuals review their affairs in light of the suggested changes and consider any appropriate actions.

We highlight below some of the main recommendations from report.

LIFETIME GIFT EXEMPTIONS

A person may be eligible for a number of IHT reliefs when making a gift during their lifetime, including the annual exemption of £3,000 and gifts from ‘normal expenditure out of surplus income.’ The size of the annual and other exemptions has not increased for many years.

The OTS has suggested that the various small gifts exemptions that are currently available will be replaced with a single, but higher, personal gifts allowance: this would simplify record-keeping and bring much needed clarity.

For many individuals, making regular lifetime gifts is a straightforward way to pass funds to the next generation tax-free and will be part of their wealth plan for the family. So it is perhaps more controversial that the OTS has proposed that the exemption for regular gifts out of an individual’s ‘surplus’ income should end. This could restrict amounts of regular ‘exempt’ gifts an individual can make, particularly for those using their surplus income to make substantial regular gifts (ie amounts well above even a new annual exemption).

BUSINESS PROPERTY RELIEF (BPR) - DEFINITION OF ‘TRADING COMPANY’

BPR is a valuable relief that can give 100% IHT relief for trading assets. Subject to a number of other conditions, BPR is available for shares in companies that are ‘mainly’ trading.

The OTS report proposes that the definition of ‘trading company’ be amended to bring it into line with the test for Entrepreneurs’ Relief, ie the company must be considered to not have ‘substantial non-trading activities’. Generally, this will mean that the company’s trading activities must constitute at least 80% of its whole activities.

As the current definition of a trading company for IHT purposes says the company must be ‘wholly or mainly’ trading, this is usually understood to be a 51% test, ie if more than 50% of the activities are trading, it can qualify. Raising this threshold to 80% is likely to mean that many companies would no longer be eligible for BPR.

Individuals holding shares in businesses which are structured as companies should review their future eligibility to this valuable relief under the proposed new rule.

CAPITAL GAINS TAX (CGT) BASE COST UPLIFT

On death, IHT is charged (subject to reliefs) on the market value of assets in the individual’s estate. To avoid double taxation, individuals inheriting assets from the estate are treated as acquiring them at market (probate) value (ie there is a corresponding uplift to the original CGT base cost of the assets). This uplift for CGT purposes is available even if no IHT is actually paid on the asset.

The OTS recommends that the CGT uplift is removed where no IHT has been paid on the asset because reliefs or exemption are available (eg, the spousal exemption, BPR or Agricultural Property Relief). CGT on a subsequent disposal by the estate or beneficiary would be calculated by reference to the original base cost of the asset (broadly, what the deceased paid for it, possibly many years earlier).

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This is clearly not a simplification, as asset histories will have to be traced on death and it will require the original acquisition records to be passed on to the beneficiary. However, the OTS has recommended this change because it believes the current rule ‘distorts’ the behaviour of taxpayers and lead to loss of tax to HM Treasury.

Where individuals have carefully planned how to pass assets to their beneficiaries tax-efficiently on death, it is likely that these plans would be affected by such a change. There may be significant CGT costs to be paid by the estate or beneficiaries inheriting assets that the deceased had owned for many years.

TIME TO REVIEW CURRENT PLANS

If these proposed changes are implemented in a future Budget, the existing wealth succession plans of many families will no longer be tax-efficient. It is important to understand how your family’s plans may be affected and what remedial action would be needed to protect the interests of future generations.

If you want to review and update your plans, please get in touch with your usual BDO contact for help and advice.

CONTACT US TODAY:



MAYBETH SHAW

Partner

maybeth.shaw@bdoni.com



FIONA HALL

Principal

fiona.hall@bdoni.com

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