



Law Society
of Scotland

Written Evidence

Inheritance Tax Review

June 2018



Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Tax Law and Trusts and Succession Law sub-committees welcome the opportunity to consider and respond to the Office of Tax Simplification's call for evidence: *Inheritance Tax Review*.¹ We have the following comments to put forward for consideration.

Questions

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.

Our members working in this area will likely have completed all relevant forms in their professional capacity.

We consider that the forms could be made more generally accessible with the ability to save privately, as with Self-Assessment returns.

Much information requires (or appears to be required) to be returned more than once in the various Schedules. An example would be business or agricultural property which is also jointly owned. It would be helpful if there was a 'one touch' approach to return all information required, rather than duplicated information being provided.

¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/702732/IHT_call_for_evidence_.pdf

The IHT100 Worksheet form itself is long and convoluted. We consider that this could be simplified or completely removed altogether. There are a number of templates that exist that could make the process more transparent and easier to follow.

We consider that the guidance is generally good and comprehensive. It would perhaps benefit from the inclusion of more examples and/or specimen entries. We are concerned however at the lack of an adequate service where guidance is required beyond matters covered in the written, electronic version. Such cases may be comparatively rare but are in comparison, more important and often urgent. Our members consider that the service currently offered is poor and requires improvement. There are two levels of query – enquiries from non-professional users about which we cannot make comment, and those from professional users and advisers, who will not wish to spend time on matters that are already covered in the written guidance. We consider the fact that individuals have difficulties accessing necessary guidance in an effective and efficient manner in the relatively few cases when it is required is a serious problem.

A specific point which we mention elsewhere is the definite need for a dedicated Scottish service. There are Scottish points which often require informed input from HMRC as the law is different from that in other jurisdictions, as it is in basic matters such as trusts, forced inheritance, general intestate succession, land law and a range of other matters.

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.

We consider that the deadlines should be the same for IHT payment and form return, but emphatically consider that the uniform date should be 12 months after death. There is still a considerable incentive to complete payment and form return well within that time, due to restricted access to assets without Confirmation having been granted (Scottish equivalent of probate). The six month deadline is often too short in practice for two main reasons – by definition, the estates requiring a full IHT return tend to be more complex; and ascertaining the relevant information within the shorter period is often unrealistic, especially where the human sources of much of the required information may be for a considerable time affected by the very personal impact of the relevant death.

We are of the view that there is a specific Scottish reason for extending the six-month deadline - debts in Scotland may be intimated in relation to the estate for a full period of six months after death, and the expiry of that period in all cases would provide a further degree of certainty of the total net estate.

Further uncertainty within the shorter period arises from possible cohabitant claims and the possibility of legal rights claims by spouses, civil partners or children, although these latter mentioned claims are not restricted specifically to a six month deadline.

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?

We consider that this process is unfair and would merit change. As is noted, the executors will not have access to the estate assets in most cases before Confirmation is granted; and yet are expected to find a means to fund the payment of IHT without access to the assets on which it is charged.

We suggest that the situation be reversed, so that IHT is payable after a reasonable period (say 3 months) after Confirmation has been obtained, to allow assets to be realised where necessary. As the executors have a personal liability to pay the tax from available estate assets which pass through (or could pass through) their hands, we are of the view that there is almost no likelihood of distribution of the estate without the IHT liability being met and indeed finalised. The current rules address a problem which we do not consider exists; and changing it would require no further change to current liability on executors.

We consider that the instalment option does not address this problem to the necessary extent, in that it only applies to assets which qualify for payment by instalments. In our view, the ability to pay by instalments does not have a fundamental connection with this rule, but rather it has the aim of allowing assets to be passed on without the need for realisation to meet the tax liability on such assets.

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?

We are of the view that the need for a full IHT 400 in many cases where the spouse exemption applies in full is unnecessary. This is the case where the total estate is over £1 million, but also where the rules on foreign property, trust assets, and/or lifetime gifts come into play or for estates where claims are made for the transferable Nil Rate Band (NRB) and/or Residence NRB. If the spouse exemption applies, we consider that there is no need for full information compliance in any such case. Any such change could be subject to HMRC's right to 'call in' estates otherwise exempt from full reporting, to check that the exemption is not being abused.

HMRC could perhaps be expected to demand further information if there was any reason to doubt that the exemption applied, for example because of any unusual feature to the marriage or civil partnership; or where the recipient spouse was not UK domiciled. In cases where full exemption is apparently available, both partners were UK domiciled at the time of death and the marriage took place in the UK, we consider that there should be no need for full reporting regardless of the size and nature of the estate.

We consider it would be reasonable for the questions in the C5 form to be expanded to highlight to HMRC cases which they might want to 'call in' for further investigation even though no IHT appears to be payable.

This would vastly restrict the circumstances in which a full IHT400 would be needed when no IHT is payable, leaving estates where APR or BPR is claimed as requiring a full IHT400.

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?

If current rules are to be retained on reporting, examples in the guidance of the estates on which no IHT is payable but where reporting is required would be useful. In addition, it could be made much clearer that lifetime gifts given within seven years of death may well bring IHT consequences regardless of the situation with the death estate.

In relation to legal rights, we consider that the rules in section 147 of the Inheritance Tax Act 1984 should be extended to all cases where legal rights for children are in point. We do note that the use of 18 years as the relevant age is no longer in keeping with the underlying Scots law which is 16 years. If the provisions of section 147 were extended, it would mean that matters could be finalised on the condition that executors are obliged to inform HMRC if legal rights are to be claimed.

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?

We have no comment to make on this question.

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

There are a number of things which could be done to assist executors in the administration of estates.

It would be of assistance if the extent of reasonable research required by executors were made much clearer. For example, what exactly is required if there is no reason to expect that significant lifetime gifts have been made and physical bank statements are simply not readily available, and may not be available at all, even on application, for period longer than five years?

It should be made clear that the onus is also on recipients of lifetime gifts to report those to HMRC on a death within seven years. If HMRC obtain evidence of lifetime gifts (for example from tax returns revealing assets no longer owned at death) we consider that they should be prepared to share that information with executors at the earliest possible opportunity. The aim of executors will rarely be to deliberately conceal the situation, and in such rare cases, HMRC already has formidable powers to enforce the payment of liabilities.

There appears to be considerable duplication in forms to be completed if different reliefs are being claimed. We consider that improvements could be made to simplify this process to assist executors.

In practical terms, it seems that the IHT forms are, once submitted, spread amongst various HMRC examiners working in specialist teams on big estates, for example APR, BPR, and historic building exemption. While there may be an advantage to having a specialist team dealing with matters, there does not appear to be an opportunity for matters to be passed to specialists in Scots Law, particularly examiners with experience in Scottish property and/or succession law. It would also be of benefit for greater resources to be dedicated to more complex cases. This is likely to be a small number of cases.

In the experience of our members, centralised services are very difficult to deal with due to a lack of specialist knowledge in Scots law, which differs in key matters to that in the rest of the UK. For example, property and land law, agricultural tenancies and trust law all differ in Scotland from that in the other UK jurisdictions. At the least, an enquiry line for Scottish matters would assist considerably and it would be useful to be able to communicate with HMRC via a secure email system. An allocated HMRC base in Scotland would be particularly helpful. We understand that digitalisation was introduced in England and Wales but has not been introduced in Scotland. This would also assist greatly in the expeditious administration of estates.

Closure time on estates is generally excessively long. There would be merit in having a deemed closure time, for example at 20 months post-death, to allow for deeds of variation to be entered into and matters concluded. We envisage that this would be conditional on there having been correct reporting and payment of IHT within 12 months.

Recent changes to the system involving C5 forms have been most welcome, allowing reporting to HMRC and application for Confirmation to proceed in parallel. We suggest that this is extended to IHT400 forms. It is not clear why the acknowledgment of an IHT400 form and payment frequently takes a number of weeks or even months to be issued by HMRC.

A number of our members find that HMRC calculations often do not agree with adviser calculations. Clarification of terminology used by HMRC and an explanation of the figures that HMRC use in their calculations would be useful. HMRC's workings could and in our view, should also be shown, perhaps particularly where the figures generated do not match with adviser calculations.

In relation to trust inheritance tax returns, clarification of terminology used by HMRC would be useful to avoid confusion, such as applicable and effective rate and periodic charges. Likewise, an explanation of the quarters used for periodic and exit charges on the calculations would be of assistance as, despite using HMRC's online calculators, these often also do not match up. This can result in slight but disturbing differences in amounts due. This is even more important in relation to interest calculations.

As referred to above, it is increasingly common to find that adviser figures do not match exactly with HMRC's calculations. Notwithstanding the fact that a return has been submitted timeously, HMRC often adds interest to any outstanding amount for a period of sometimes up to a year. It appears that in a number of cases, this could be avoided if HMRC processed trust tax returns more efficiently.

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?

In tax-paying cases, formal valuations are almost inevitably required. With some assets (notably quoted shares), this is quick and reasonably cheap, although we suggest that HMRC accept 'newspaper' valuations rather than formal valuations to minimise expense. We consider that this would be at little cost to potential lost revenue.

Land is much more difficult. In order to avoid dangers in undervaluation, a formal valuation may almost always be required. A full 'Red Book' valuation is generally obtained at a cost which is not commensurate with the tax at stake. We consider that there may be merit in the onus and timing being reversed – an executors' informal valuation could be accepted unless and until HMRC indicate that they are going to instruct their own valuation; and the executors can then decide whether it is worth instructing their own valuation in turn. We are of the view that this should not be necessary in many cases if District Valuers accept clearly and accurately their duty to provide an objective assessment of market value, rather than arguing for the maximum valuation of the asset.

In relation to property contents, current advice is for a formal valuation to be carried out. We consider that there would be benefit in having an accepted estimated value for contents in the majority of cases, unless a formal valuation is obtained or special circumstances apply (based perhaps on the value of the property where contents are held at the date of death).

There are difficulties in practice with having District Valuers inspect and report, particularly in more remote areas of Scotland. This makes it difficult for executors to progress cases expeditiously. It seems that valuation visits can be difficult to arrange and are often postponed.

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.

Rules in relation to reliefs and exemptions available on lifetime gifting are relatively straightforward. Having one generic nil rate and (NRB) and residence nil rate band (RNRB), however, would make matters more transparent. A fairer result might be produced if, as an example, tax free allowances were set at a maximum level according to the relationship between the beneficiary and donor.

The simplicity of the current regime is complicated in Scotland where there is interaction between non-exempt and exempt beneficiaries and IHT is payable, particularly when a legal rights claim is made by a descendant or a spouse. Such claims can move what may be a relatively simple estate and tax calculation into the rules on partial exemption, which are notoriously complex.

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?

We do note that there would be costs involved, but we consider that the single biggest change in this area which could be made would be that tapering should apply to the gift, not the tax on that gift. Many people assume that this is the case in any event; and assume that gifts within the nil rate band more than three years before the death will benefit from taper relief, when of course they do not. We consider that taper relief on gifts generally is widely misunderstood and of very limited application. Abolishing taper relief would significantly simplify matters in this area.

The interaction between lifetime chargeable gifts and potentially exempt transfers (PETs) which become chargeable is very complex; PETs which become chargeable within seven years of death then require the seven year period before the PETs to be considered and this potential requirement to look back up to 14 years before the death is unduly burdensome. There are also complications caused by PETs which take place before lifetime chargeable transfers, where the loss of the assumed exemption can cause complications for the chargeable transfer and indeed future charges in relation to the trust which may be involved. Such complexities are inevitable in the current scheme of IHT, but could be eliminated by a broader brush approach to the seven year period underlying chargeability to IHT.

The interaction between reliefs (in particular APR and BPR) and exemptions requires greater explanation, especially as a new level of complexity has been introduced by recent restrictions on the deductibility of debts.

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

The majority of reliefs and exemptions are reasonable and necessary. The levels of annual exemptions are however out of sync with reality. The present annual exemption of £3,000 and small gifts exemption of £250 were set in 1980/81. If these figures had been increased in line with inflation they would now be over £11,000 and £1,000 respectively. We consider that there would be merit in increased limits for these exemptions, to figures roughly in line with inflation. With a larger annual exemption, the position with lifetime gifts could be simplified by not allowing carry forward of the previous year's exemption and the separate category of exemptions for gifts given on consideration of marriage could be abolished. Larger lifetime exemptions would relieve clients and agents of a considerable amount of detailed record keeping which is often out of proportion to the amounts of gifts and exemptions involved.

The exemption for normal expenditure out of income is often potentially relevant, but the paperwork required to claim the exemption can be unreasonable and unrealistic. We consider there is scope for considerable simplification, for example to provide for an exemption based on a percentage of income.

We also consider that treatment of actual claims for reliefs and exemptions is lacking in consistency in practice.

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))?**

We note that there are differences in the rules for BPR and Capital Gains Tax (CGT) business relief. We acknowledge that it is perhaps appropriate to have a less restrictive test for BPR given that this commonly applies to the passing on of businesses within a family after death, compared to CGT business relief which usually arises in the sale of business, which will usually be by choice. This fits with a policy objective of preserving businesses to pass on.

Furnished holiday lettings qualify for CGT business relief but not for BPR. We consider that this is an anomaly which would merit review.

We also note that the scope of holdover relief has been much restricted in recent years and this has given rise to complexities in relation of CGT business relief.

The presence of reliefs undoubtedly affects decisions on structuring of business. A particular example of this is in the field of renewable businesses. It is unlikely that the effect on business structures will change so long as reliefs are available. In relation to investment in unlisted trading companies, in particular those traded on the AIM and in forestry, our members' experiences suggest that individuals choose to invest in these fields, at least in part, with the relevant reliefs in mind. We consider that the reliefs promote and encourage business and investment. We do not seek to comment on the merit of the relevant reliefs themselves as their availability is a policy decision. It appears that the reliefs have had, and continue to have, what appears to be the desired effect.

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?

The differing rules certainly do cause complexity. A single set of rules and particularly definitions would be preferable for reasons of simplicity, but as noted above the reliefs for the two taxes have somewhat different policy functions. However, we consider that to simplify the current system on the basis of the most restrictive form of 'business' relief would be a counsel of despair.

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?

We consider that this feature reduces complexity. IHT is an event tax and the event is a death leading to the inheritance of the asset. If a party chooses to sell an asset post-death, the option to make payment of IHT by instalment is lost. The proportionate size of the holding in an entity considered appropriate for the relevant relief should not determine its availability – indeed where such proportionate restrictions existed in the past (for example as regards BPR on shareholdings) this increased complexity considerably.

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,
- b) the choice for farm owners of letting out farmland versus farming themselves or via a contract farming arrangement,
- c) the inhabitants and use of the farmhouse,
- d) the choice of business vehicle for the farm (for example a corporate entity, partnership, unincorporated business), or
- e) the structure of the business (for example, how to diversify or hold non-trading assets)?

In relation to APR and BPR, we note that the original purpose of the reliefs appear to have been watered down. The IHT forms seem to guide executors and agents towards claiming BPR rather than APR.

In terms of farms, the high level of capital investment required makes it difficult for farmers to enter the market without initially acquiring a tenancy. We consider that any further restrictions on let farmland are likely to have a terminal effect on the letting market, which is a particularly important factor in relation to Scottish farmland.

In relation of farmhouses, there does not appear to be consistency in approach by HMRC as to how these will be treated. In relation to the attitude taken to the restriction of APR on farmhouses (where there appears to be a 'standard' attempt to restrict 30% of the value), this frequently leads to costly and expensive negotiations. Farmhouses do form a very specific business setting and specific treatment may thus be required.

There are particular worries for individuals where the farmer has been unwell or incapacitated and not carry out as much farming work as in the past. The case law is particularly mixed and uncertain on this matter.

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

Please see our comments above in relation to farmhouses. We consider there could be simplification in relation to this. In relation to farming, it should be recognised that the high capital value is generally not commensurable with the levels of income. There tends to be much greater levels of succession in farming compared to other industries.

We consider that there is, on occasion, a lack of expertise and resources within the District Valuer's office in respect of farms.

Without a legislative definition, there are no clear criteria for a property being a farmhouse. Current tests focus on the farmer being the person actually carrying out the farming, rather than simply managing the farm. This would merit consideration given the Government's wider encouragement for diversification in agriculture. Any statutory test is likely to be restrictive and we suggest that careful framing will be required.

In relation to let farmland, we of the view that the relief should depend on the farmland being let on an agricultural tenancy, without restrictions being imposed by permitted, and in many cases encouraged, diversification from farming activities by the tenant.

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?

We consider that in cases with a working farmer, individuals should be able to claim either BPR or APR. Formally allowing individuals to apply for either or both reliefs (which happens in practice anyway) would

reduce the complexities. There would require to be provision however, that letting farmers would not lose access to claim APR as they would not be entitled to make a BPR claim. We do recognise that this may result in uncertainty as to who is carrying out farming where land is tenanted.

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.

In the experience of our members, the lower rate of tax on death where more than 10% of the estate is left to charity is not well understood by the public generally, although the charitable exemption generally is understood. The complexities are very heavy and we consider there should be much greater up-front information available about these matters. One particular issue which has arisen in practice is in relation to charities which are not UK-registered. Unless registration is finalised within two years of death, the exemption cannot be claimed. Although this restriction will probably require to be retained, it would be of assistance if this was better publicised.

It is particularly complex to provide within a will for the lower rate of IHT on death to apply where the charity bequests exceed a particular sum or percentage of the estate, especially for non-specialists. The options are to specify the amount of the legacy (which may not be sufficient to trigger the reduced rate in the event) or to specify the percentage of the estate that gets divided between charities, and then the testator could end up giving a larger sum than expected to charity. We do question whether the lower rate of IHT on death gives rise to any greater level of charitable donation than if the relief did not exist.

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.

Transferable nil rate band (transferable NRB) is complicated and does not take account of the wide range of modern family dynamics. Having said that, the benefit of the transferable NRB is that it may save the need to set up a trust on the death of the first spouse. This is likely to be particularly relevant in smaller estates where the parties may not be comfortable with the concept of a trust.

The residence NRB is extremely complex. We consider it does not have fair application given that it only applies to those who own residential property, and to those who pass assets to children. This could be changed to either a £500,000 nil rate band for everyone, or a £325,000 nil rate band for everyone with an

enhanced nil rate band of £500,000 in total where you are survived by children and leave them up to £500,000.

Since 2006 there have been significant changes to the laws in relation to entities and trusts. We consider that further reform may affect stability and predictability in this area. By their very nature, trusts are often intended to be of long duration and significant changes in the regime (as was the case in 2006) can cause unnecessary complexities to arise. The need to consider different law at the time when a trust was established when considering current tax treatment should be avoided where possible.

There would be merit in broad axe simplification in relation to the NRB and trusts, similar to that found in relation to CGT and rent-a-room relief. The freezing of the NRB in recent years has added to difficulties.

In relation to the IHT treatment of personal pensions, we do not consider that there are difficulties with this due to provisions around death benefit trusts. There can however be severe difficulties in relation to life insurance policies, including in relation to chargeable events on death.

Finally, we consider that the conditional exemption provisions are very technical in nature, although self-contained within the IHT legislation. We consider that in relation to both conditional exemption and the acceptance in lieu scheme there should be opportunities for Scottish and other cultural bodies to contribute directly in relation to qualification for the relevant reliefs.

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?

We consider that it is a policy decision as to whether some exemptions and reliefs should be removed to fund a lower or graduated rate of IHT or a higher NRB. We do not therefore offer a view on this. If certain exemptions were to be removed, there is likely to be an increase in the number of estates liable to tax. Tax is widely used as an economic instrument for other policy decisions and doubtless IHT is no different in this regard.

We recognise that there may be benefit in greater root and branch change in relation to IHT. However this would require to come hand-in-hand with review of other tax, trust and succession matters. There is certainly scope for IHT to have more than one positive rate of tax, thereby making IHT more progressive, although that would necessarily increase complexity. This is a policy decision. However, this is generally considered to be a fair approach to taxation and would be in line with the treatment of other taxes.



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