

IHT: 'Doubling up' on BPR

Background

Business property relief (BPR) reduces the value transferred by a transfer of value of certain types of business or business property, at current rates of 100% or 50%.

Certain conditions must be satisfied for BPR to be available (e.g., relating to the type of business carried on, and the length of ownership of the business or business interest).

Where BPR is available, it can apply to lifetime transfers and relevant business property included in an individual's estate on death.

Married couples and civil partners

In the case of married couples (or civil partners), if (say) a spouse leaves relevant business property eligible for BPR at 100% to the surviving spouse on death, this will generally result in BPR being wasted on the first death.

This is because the business property will normally be subject to the IHT spouse exemption, so there is no IHT liability in any event, although the exemption may be subject to restriction if the recipient spouse is non-UK domiciled (IHTA 1984, s 18(2)).

Example 1: BPR wasted

Jamie died in January 2020, having made no lifetime gifts. His death estate was worth £1,950,000, comprising: the family home, valued at £650,000; bank and building society accounts and cash ISAs amounting to £850,000, and 50% of the shares in Famco Ltd, a family company that makes office furniture, valued at £450,000.

In his will, Jamie left cash of £325,000 to a discretionary trust for his UK-domiciled widow Delia, plus his adult children and grandchildren. The remainder of his estate was left to Delia, amounting to £1,625,000. Consequently, there was no IHT liability on Jamie's estate.

However, Delia's estate has increased in value by £1,625,000, so the potential IHT exposure for Delia's estate is higher, even though her estate may be eligible for the residence nil rate band if the family home is left to lineal descendants, and the shares in Famco Ltd may be subject to BPR in the future.

Example 2: BPR used on first death

Now suppose that instead of the Famco Ltd shares being left to Delia, Jamie leaves the shares to the family discretionary trust instead.

There is still no IHT liability on Jamie's death estate, as the shares left to the discretionary trust are subject to BPR at 100%.

The value of assets in the discretionary trust has increased from £325,000 to £775,000, due to the shares in Famco Ltd.

Delia's estate has increased by £1,175,000 following Jamie's death, comprising the family home worth £650,000, and cash deposits of £525,000. So BPR has been claimed on Jamie's death, and there has been a reduction in Delia's estate of £450,000.

The discretionary trust is potentially liable to IHT charges, mainly on 10-year anniversaries and when trust assets are appointed to beneficiaries. The IHT rates for trusts are generally lower than for individuals (i.e., normally a maximum IHT liability of 6% for the trust every ten years, as opposed to 20% for chargeable lifetime transfers by individuals or 40% on death).

However, the shares in Famco Ltd might become eligible for BPR once again if they are held for at least two years. In the meantime, Delia can potentially benefit from the trust assets as a discretionary beneficiary.

A 'double dip'?

In some situations, it may be possible for BPR to be utilised for a second time in respect of the same business property, when looked at in the context of a family unit, such as a married couple. This type of planning is sometimes referred to as BPR recycling, or 'double dipping'.

As with most types of tax planning, it must come with a 'health warning'. BPR recycling isn't one of the examples of abusive planning given by HMRC in its guidance on the general anti-abuse rule (GAAR). However, that does not mean that HMRC will necessarily refrain from challenging a BPR recycling arrangement, particularly if it is considered artificial.

In addition, before undertaking tax planning arrangements, it needs to be considered whether the arrangements must be notified to HMRC under the disclosure of tax avoidance schemes (DOTAS) provisions. Furthermore, members of the main tax and accounting bodies should refer to the guidance from their professional body regarding 'Professional conduct in relation to taxation' (PCRT) in relation to tax advice (tinyurl.com/PCRT-HS-TA). Solicitors and barristers practising tax have their own professional bodies' standards to maintain. Tax advisers who are not affiliated to any professional body will need to refer to HMRC's standard for tax agents (tinyurl.com/HMRC-SFTA), which includes standards for tax planning.

These issues are not considered further here but are mentioned to highlight the importance of due diligence when considering all but the most basic tax planning.

Example 3: The same again?

Following on from Example 2 where Jamie's shares in Famco Ltd were left to a discretionary trust, suppose that following Jamie's death, Delia became keenly involved in the running of the family business.

She bought the shares in Famco Ltd from the trustees of the discretionary trust for £450,000 (which is assumed to still equate to the market value of the shares). No capital gains tax (CGT) is payable by the trustees, as there was a CGT-free uplift in the value of the shares to £450,000 on Jamie's death. However, Delia will be liable to stamp duty at 0.5% of their purchase price, so there is a stamp duty liability for Delia of £2,250.

The cost of the shares for Delia was funded out of the investments inherited from Jamie. So the position after the share purchase is that the discretionary trust holds cash deposits of £775,000 (i.e., £325,000 + £450,000).

Delia's estate includes the family home worth £650,000, the shares in Famco Ltd worth £450,000, and cash deposits of £75,000 (i.e., £525,00 - £450,000), so £1,175,000 in total.

If Delia survives at least two years following the acquisition of the Famco Ltd shares and assuming BPR at 100% is still available in respect of the shares, the IHT on Delia's estate in respect of the assets inherited from Jamie is limited to the family home and remaining cash deposits. In the meantime, as mentioned the trustees of the discretionary trust may decide to allow Delia to benefit from the trust by making distributions to her as a beneficiary.

Future changes?

Because BPR is such a generous IHT relief, there is always a danger that BPR may be restricted or withdrawn in the future.

In July 2019, the office of tax simplification (OTS) published a report entitled 'simplifying the design of inheritance tax', which followed a consultation on the subject. One of the observations made by the OTS was that abolishing business and agricultural property relief would fund a reduction in the main rate of IHT from 40% to around 33.7%. The OTS recommended some significant IHT reforms. Whilst none of those reforms have so far been implemented, the possibility of further IHT reviews and the potential reduction or withdrawal of BPR in the future cannot be ruled out.

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