

The impact of S162B(7) IHTA 1984 (Lecture P1388 – 15.47 minutes)

From an IHT perspective, care must always be taken with mortgages and other liabilities.

If a loan is charged on a business asset, relief is only given on its net value (S162(4) IHTA 1984). This has the effect of wasting the benefit of business relief.

If that loan, despite having been taken out to acquire, say, a close company shareholding, was secured on the shareholder's *private* property (e.g., their home or a portfolio of quoted shares), business relief used to be available on the full value of the relevant business property. Any income tax relief for interest paid on the loan is not affected by the nature of the collateral – see s.392 ITA 2007.

In a surprising announcement which appeared to be an attack on what had previously been regarded as relatively unaggressive and sensible tax planning, HM Treasury stated in FA 2013 that the rules dealing with deductible liabilities for IHT purposes were being tightened up in respect of liabilities incurred on or after 6 April 2013.

In relation to what the legislation calls 'relievable property', the relevant provision is s.162B IHTA 1984. This section covers liabilities incurred to finance – directly or indirectly – the purchase of property which qualifies for business relief (or agricultural relief).

If the liability has been incurred to acquire, maintain or enhance property which is eligible for business relief, s.162B(2) IHTA 1984 provides that this liability reduces the value of the relevant business property (rather than any other property on which the loan may be secured) so that only the *net* value of the property will attract relief. This has put a stop to the widespread practice of borrowing against the collateral of (typically) a valuable main residence and using the loan to acquire an AIM portfolio which, in two years' time, should attract 100% relief.

If the liability has been incurred to acquire, maintain or enhance farmland and farm buildings which are eligible for agricultural relief, s.162B(4) IHTA 1984 provides that this liability reduces the agricultural value of the farmland and farm buildings so that only the *net* agricultural value of the property will attract relief.

Where assets which qualify for business relief (for example) have been acquired using borrowed funds and the liability has been secured against other chargeable assets, it would still be possible to obtain full relief and a deduction for the liability by:

- (i) giving away the relievable assets before death; but
- (ii) retaining the liability within the estate.

As has been seen, s.162B IHTA 1984 requires that the liability is set against the value of the relevant business property, but with any excess value over the amount of the liability qualifying for relief. However, at death, the transferor's estate would no longer include relievable property and so the provisions of s.162B IHTA 1984 would not apply. The liability could then be deducted against the death estate under s.162(4) IHTA 1984.

In an effort to prevent this, s.162B(7) IHTA 1984 stipulates that, where a liability has already been taken into account to reduce the value transferred by a chargeable transfer, the liability

cannot then be taken into account to reduce a subsequent transfer made by the same transferor.

As HMRC put it:

‘The wording used is important. The liability must reduce the value transferred by a chargeable transfer (i.e., a transfer which is immediately chargeable or a failed PET). If the lifetime transfer was a PET and the transferor survives seven years, the transfer is an exempt transfer. So, the liability may still be deducted from the estate on death as it will not have (been) taken into account by an earlier chargeable transfer.’

Example 1

Denis, who has an estate worth £5,000,000, borrows £750,000 from his bank and uses this to purchase relevant business property. Three years later, Denis gives the business property (now worth £900,000), to Elizabeth, his daughter. However, Denis retains the liability.

Denis has made a transfer of value when he gives the business property to Elizabeth and the value transferred is the loss to Denis’ estate of £900,000. S.162B(2) IHTA 1984 has the effect of reducing the £900,000 value of Denis’ gift by the amount of the loan (£750,000) to £150,000. This figure of £150,000 is then eligible for 100% business relief, reducing the value transferred to nil.

When Denis dies four years after making this gift (i.e., a failed PET), leaving an estate of £5,000,000, the liability of £750,000 cannot be taken into account for a second time because of s.162B(7) IHTA 1984. Instead of the transfer on Denis’ death being (£5,000,000 – £750,000) £4,250,000, it is the full £5,000,000 which is charged to IHT with no deduction for the bank loan.

Example 2 – exempt transfers

Frank and Geraldine are an elderly married couple who are resident and domiciled in the UK. Frank owns assets (including the family home) valued at £2,800,000 in his own name, while Geraldine has property worth £1,200,000. They are therefore worth a total of £4,000,000.

Frank borrows £600,000 which is charged against the value of the main residence. He uses this money to finance the purchase of an AIM share portfolio which he transfers to Geraldine one month later. Frank dies three years after the gift of shares to his wife.

The gift to Geraldine is an exempt transfer between spouses by virtue of S18 IHTA 1984. This transfer is not reduced by business relief and so S162B(1) IHTA 1984 does not apply. The liability which Frank incurred in order to acquire the AIM shares is not taken into account in connection with this lifetime transfer.

The chargeable transfer which is deemed to occur on Frank’s death is not reduced by business relief and so s.162B(1) IHTA 1984 is not in point. Because the subsection does not apply, the liability of £600,000 incurred by Frank can be deducted from the value of the house on which the debt is secured, as long as the provisions of s.175A IHTA 1984 are met (i.e., that the liability is discharged out of Frank’s estate – which it presumably will be).

It follows that Frank, at the date of his death, has assets worth £2,800,000 – £600,000 = £2,200,000 (the rest of his estate is assumed not to have changed in value).

Geraldine's estate is now worth £1,800,000 (her original asset value of £1,200,000 plus the share portfolio gifted by Frank). However, in her case, the AIM shares will qualify for 100% business relief, leaving a chargeable estate of £1,200,000.

Between the couple, Frank and Geraldine's combined chargeable estate of £4,000,000 has been reduced by £600,000 to £2,200,000 + £1,200,000 = £3,400,000.

Notice that, if Frank had kept the shares in his estate, the transfer on his death would have included both the relevant business property and a liability to acquire relieviable property. S.162B(1) IHTA 1984 would then have been in point and so the liability of £600,000 would be taken to reduce the value of the share portfolio before the application of business relief. With no business relief available, Frank's estate would have remained at £2,800,000. Geraldine's estate would have been unaltered at £1,200,000, giving a combined chargeable estate of £4,000,000.

Contributed by Robert Jamieson