

Inheritance Tax Planning pitfalls (Lecture P1399 – 18.26 minutes)

Although inheritance tax (IHT) is only responsible for about £7bn of Government revenues out of nearly £800bn, there is a disproportionate amount of attention on planning in this area. The questions that need to be asked from the beginning are whether significant IHT planning is appropriate for the client.

On too many occasions, planning is entered into that is not appropriate and is not in the long-term interests of the client.

The arguments for IHT planning centre around the very large IHT liability at 40% which is a high figure by comparison with similar inheritance taxes across the world. However too often the planning goes wrong—sometimes disastrously.

A crucial element about IHT is that one only knows whether the planning is effective when the person has died. Normally IHT is levied on the death of an individual and therefore it is the laws at the time of the death that are relevant. As most people don't know when they are going to die, this is acutely relevant. I once had a client who was in the process of being talked into an IHT scheme by a promoter. He then asked me whether one could guarantee that it worked, and I said that no one could guarantee whether an IHT scheme would work as one cannot guarantee what the law will be when you pass on. The client did not do the scheme.

IHT planning is quite often a long-term exercise, and one needs to take account of the fact that governments not only change but so can legislation. For example, home loan schemes were popular a couple of decades ago; so much so that the government introduced the pre-owned assets tax regime which created an income tax charge on the benefit in kind value of the asset. What looked like a very neat way of side stepping the gift with reservation of benefit rules became a bureaucratic nightmare and costly in tax too, unless you opted back into the gift with reservation regime. The old saying of 'if it looks too good to be true it probably is' was certainly valid on this occasion. A recently decided case *The Executors of Mrs Leslie Vivienne Elborne and others* (TC08863), shows the perils of pre-owned asset tax planning.

The problem with giving assets away is not only that you no longer have use of them but also the potential capital gains tax charge on the disposal of the asset which increasingly comes into play as the annual exemption was reduced to £6,000 for 2023/24 and £3,000 for 2024/25.

For most taxpayers, their largest asset is their property that they live in and that is less susceptible to IHT planning as they need somewhere to live and there are specific rules, such as the gift with reservation of benefit and pre-owned asset tax that prevents these assets falling out of the estate for IHT purposes.

Probably the worst form of IHT planning is almost anything to do with one's private residence. It is natural to think whether one can avoid IHT when passing over or bequeathing the private residence. However, a lifetime gift appears not to be a particularly wise choice. The restrictions on the subsequent use of the property by the donor should not be underestimated and are invasive of one's privacy, to put it mildly. Lease carving is also unlikely to be effective, particularly if the taxpayer wishes to retain a significant interest in the property. The decisions in *Lady Ingram's Executors v CIR* and *Viscount Hood (executor of Diana, Lady Hood deceased) v HMRC* CA (2018) reinforce the point.

I came across a question posed in a forum for a Sunday newspaper where a father was writing that his daughter was pestering him to gift the property to her and she would 'sort out' the rental requirement for it to be out of his estate. He would need to pay market rent to her in order to avoid the gift with reservation clause. Quite apart from the seeming unfairness of someone who is paying rent on what was their own property and the dangers in giving assets to a relative who is pestering you, the rent would represent taxable income to the daughter and so all that is being achieved is paying income tax in stages instead of IHT.

The other challenge is that people often underestimate the amount that they will need for a comfortable existence after retirement, particularly as they cannot know how much healthcare support they will need in their later years.

The curious element about IHT is that the richer one is, the more opportunities one has to avoid IHT. Take the simple example of giving money away and surviving 7 years. That is only a realistic possibility if one does not need that money.

Similarly, gifts into trusts are irrevocable and the individual needs to be assured they can live a lifestyle that they wish without the funds that disappear from the estate.

The recent case quoted in the Tolleys July update is worth repeating. Mr and Mrs Bhaur were partners in a property partnership that owned 35 properties. Looking to substantially reduce any inheritance tax payable, the couple entered into a scheme under which the business was transferred to an employee benefit trust, which excluded Mr and Mrs Bhaur but benefited younger family members, including their son.

After it became apparent that the scheme was ineffective, the couple applied to the High Court for the last of these transactions to be set aside on the grounds of mistake. The High Court dismissed the claim, holding that there had not been a mistake (i.e., relating to a past or present matter) but instead a misprediction (relating to a possible future event); the couple had miscalculated the consequences to them if the scheme went wrong. The Court of Appeal upheld the verdict of the High Court.

You also need to consider the challenges of the family. HMRC seems to take the view that the whole family will cooperate to deprive them of their "rightful taxes". In practice family dynamics are generally quite different and therefore again IHT planning becomes more difficult and hazardous. What happens if family relationships break down? What happens when individuals emigrate? How does one ensure that the funds go to descendants who actually need them given that they will have different income and capital assets and requirements? What happens if a trustee disappears or becomes difficult?

Let's not forget Sir Charles Clore who spent years being miserable in Monaco but still died domiciled in the UK. This still does not seem to deter taxpayers or their executors trying to prove a near deathbed change in their domicile as in the case *Ameet Shah (as Executor of the Estate of Anantra Maneklal Shah Deceased v HMRC (TC08842))*. The taxpayer rarely succeeds.

In conclusion, I take a very cautious view on IHT planning. If one is going to give assets away, one should rule out ever having a benefit from them in the future. This would normally exclude any gift of the main residence. If any planning is proposed, then holding assets which retain IHT advantages such as farmland, woodlands or a portfolio of AIM shares would appear to be the most sensible strategy as one does not lose permanent control of them. Again, this is advice which only the wealthy can follow; but that is probably why IHT falls disproportionately on middle income households.

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