

IHT property valuations (Lecture P1458 – 13.44 minutes)

Background

Valuations of assets in general for tax purposes is a specialised area. HM Revenue and Customs (HMRC) recognises the specialised nature of valuation work. HMRC's officers don't normally engage in tax valuations of assets; instead, they enlist the help of specialists in other government departments, such as Shares and Assets Valuation for unquoted shares, and the Valuation Office Agency (VOA) for land and buildings. Useful information on the VOA's approach to its valuation work for IHT purposes is included in its Inheritance Tax Manual (www.gov.uk/guidance/inheritance-tax-manual).

IHTA 1984, Pt VI deals with valuation. Those provisions include the related property rules, which provide that the value of related property must be taken into account when valuing a person's estate if this results in a higher valuation. Property is 'related' for these purposes broadly if it is in the estate of the individual's spouse or civil partner, or alternatively if it is, or was within the preceding five years, the property of a charity or certain other bodies to which exempt transfers may be made as the result of an exempt transfer (after 15 April 1976) by the individual, spouse or civil partner (*IHTA 1984, s 161(2)*). Potential valuation discounts for jointly-owned property is another difficult and complex issue which isn't specifically dealt with in the IHT legislation, and is not considered here.

Little help

The general valuation rule as stated in the legislation is that market value is: "...the price the property might reasonably be expected to fetch if sold in the open market at that time; but that price shall not be assumed to be reduced on the ground that the whole property is to be placed on the market at one and the same time" (*IHTA 1984, s 160*).

For IHT purposes, taxpayers and personal representatives will generally prefer a lower property valuation to a higher one, to reduce exposure to IHT liabilities. HMRC therefore regards valuations as a 'high risk' area in terms of the potential loss of IHT where valuations are too low. If HMRC enquires into a property valuation and it transpires that the property was undervalued, HMRC may seek to establish whether the valuer was negligent for penalty purposes, or whether the taxpayer failed to instruct the valuer properly.

Professional valuations

There is no statutory requirement to obtain a professional valuation of land and buildings. However, simply guessing their value is not recommended. Aside from additional IHT and interest, as mentioned, the material undervaluation of a property may result in the imposition of penalties.

HMRC's toolkit for tax agents or advisers when completing the IHT return form IHT400 for their clients (www.gov.uk/government/publications/hmrc-inheritance-tax-toolkit) states that for assets with a material value, taxpayers are 'strongly advised to instruct a qualified independent valuer, to make sure the valuation is made for the purposes of the relevant legislation, and for houses, land and buildings, it meets Royal Institution of Chartered Surveyors (RICS) or equivalent standards.'

HMRC also states that in the absence of proper instructions, the valuer will not understand the context or have all the necessary details to make a proper valuation. So, HMRC expects the person seeking the professional valuation to explain the context and draw attention to the definition of market value in *IHTA 1984, s 160*, and to provide the valuer with all the relevant details concerning

the land and property, including copies of any agreements (such as leases), or full details where only an oral agreement exists. HMRC adds (in its Inheritance Tax Manual at IHTM36275):

‘...having first obtained a valuation or opinions of value, given entirely in good faith, they may subsequently become aware of further (marketing) information which casts doubt on whether the original valuations still properly reflect the open market value of the property at the date of death. If personal representatives are aware of such information we consider it is reasonable to expect them to ensure it is properly considered and reflected appropriately in the final valuation figure included in the account.’

Development value

A particular area of potential difficulty in property valuations is ascertaining a property's development value, which has been the subject of possible disagreement between valuers, and also an area of potential dispute with HMRC. When valuing a property, HMRC expects the valuer to consider whether there is any potential for development and, if so, to ensure that it is taken into account and reflected in the valuation. HMRC states (at IHTM36275) that it considers 'hope' value to be 'a component part of the open market value in appropriate cases, whether or not planning permission has been sought or granted'. The difficulty in establishing development value has resulted in several cases before the land tribunal.

For example, in *Prosser v IRC* (DET/1/2000 [2001] RVR 170, the garden of a house was large enough to potentially constitute a building plot. The district valuer suggested a figure as at the date of death assuming planning permission, and deducted an allowance of 20% to reflect that no planning permission had been given at the valuation date. However, the land tribunal held that there was a 50% chance of obtaining planning permission, and that a speculator purchaser in the absence of the planning permission wouldn't offer 80% of the development value, but would only offer 25%.

Subsequently, in *Palliser v Revenue and Customs* [2018] UKUT 71 (LC), a valuation of an individual's interest in a maisonette was obtained for probate purposes, which didn't reflect any hope value for future development or change of use. HMRC determined the value to be £1,829,880. The personal representative appealed, on the basis that the correct valuation was £1,113,840. The Upper Tribunal (Lands Chamber) considered that insofar as the property's potential for improvement hadn't been crystallised by planning permission, its value would be 'hope' rather than 'development' value, but either way, it could not be ignored. The tribunal determined the net valuation of the property with and without development. It then took 50% of the difference as representing the hope value. This was added to the market value of the property on death. The valuation in this case was complicated slightly in that the deceased's interest in the property wasn't 100%, but 88.4%. The value representing the deceased's 88.4% share was reduced by 10% to reflect the undivided share, giving a value of £1,603,930.

Major differences

Even if professional valuations have been obtained on behalf of both the taxpayer and HMRC, the approach taken by the professional valuers might differ, resulting in major differences in valuations for the tribunal to rule upon.

For example, in *Foster v Revenue and Customs* [2019] UKUT 251 (LC), a deceased individual's estate included 6.39 acres of an agricultural site. A dispute arose between the deceased's executor and HMRC about the open market value of the site for IHT purposes. The executor (on professional advice) valued it at £191,700; On the other hand, HMRC (on the VOA's advice) valued it at £850,000. The Upper Tribunal (Lands Chamber) (UT) considered that at the valuation date a hypothetical

purchaser would have considered there to be a reasonable prospect of obtaining planning permission for the residential development of the site. However, there were problems to overcome (e.g., vehicle access to the site) which would be reflected in the price that the hypothetical purchaser would be prepared to pay. In addition, the valuation experts for the executor and HMRC took fundamentally different approaches to calculating the open market value of the site. The tribunal favoured HMRC's 'top down' approach (in other words, assessing the value of the site assuming it had residential planning permission at the valuation date and making deductions for access risk and planning risk and deferment) and applied a total risk adjustment factor of 80%. The tribunal determined the open market value of the site at the valuation date to be £590,000.

Forewarned is forearmed

The perceived high-risk nature of property valuations increases the possibility that valuations put forward on the taxpayer's behalf will be subject to enquiry by HMRC. If it transpires that there has been an undervaluation, HMRC will probably consider whether it was reasonable for the taxpayer to have relied on the valuation, or whether there something else known to them that would cast doubt on the value.

The types of questions HMRC might ask are listed in the Inheritance Tax Manual at IHTM36153 for undervaluations generally, and at IHTM36154 for undervaluations of land and buildings. The list at IHTM36154 asks:

- 'whether all relevant information available to the taxpayer concerning the property was passed to the valuer;
- that any professional valuation properly considered development potential and any 'hope' value was appropriately reflected in the overall valuation and not specifically excluded;
- whether the taxpayer questioned any valuation advice which obviously ignored relevant information or which did clearly not represent an open market valuation;
- whether any significant assumptions made by the valuer about the property which affected its open market value were checked by the taxpayer.'

In addition, if the property was for sale before the IHT return was submitted, HMRC may ask:

- 'were any offers received (if so, obtain details of any offers made, to include when they were made, by whom they were made and the amount offered).
- where applicable, were best and final sealed bids invited (if so, the same details as above should be sought).
- was a sale agreed or contracts exchanged before the account was delivered (if so, to whom, when and at what price)?'

Before submitting a valuation to HMRC, it may be helpful to consider what HMRC's approach might be if the valuation was subject to enquiry.

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