



Response from ICAS

Office of Tax Simplification - Inheritance Tax Review: Call for evidence

8 June 2018

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to respond to the Office of Tax Simplification Inheritance Tax Review: Call for Evidence published in April 2018.
3. Brexit is creating uncertainty for all businesses, including agricultural ones. The legislative workload arising from Brexit is also considerable. We do not therefore believe it is desirable or practical to pursue major reform of IHT (particularly APR and BPR) at present, although we do support long term wider reform to simplify the regime.
4. We also believe that wider reform of IHT, particularly significant changes to APR and BPR, should not be considered in isolation because of the interaction with other areas of the tax system and the risk of unintended consequences. We therefore support the OTS call, in its recent Business Lifecycle Report, for "a detailed review of the tax system as it operates on key events in the business lifecycle, to help the UK economy to maximise its opportunities and to make the system clear and simple for companies to understand and use." This review should include consideration of the two significant IHT reliefs – BPR and APR – and their interaction with other reliefs.
5. The immediate focus should be on administrative improvements and the simplification of the lifetime gifts regime, which we discuss in more detail below. This would facilitate compliance and simplify one area which causes difficulties, without creating uncertainty and unintended consequences. Post-Brexit and after the suggested detailed review, wider reform and simplification should be considered.
6. Agricultural policy is a devolved matter. We therefore believe that any review of IHT needs to take into consideration land law. Any proposals that may emerge relating to agricultural property relief should also be tested with the agricultural departments of each devolved government. With APR it is important that the policy rationale is set in the context of wider government policy for agriculture.

Forms

7. As a general point where IHT forms are available for online submission they should include three key functionality features to make them easier for agents (and others) to use.
 - a. The ability to see the whole form before beginning to complete it so that the user knows what information will be needed to complete the form before starting.
 - b. Save and retrieve functionality so that if the form cannot be completed in one sitting the user can save a draft and return to complete it later.
 - c. The ability to print the form before submission and to save a PDF version – a prompt to print and/or save should appear before the user confirms submission.
8. Form IHT 100: the form attempts to cover too many different things. When all forms were submitted on paper it may have made some sense to cover as many things as possible on one form. However, now that online forms are increasingly used it would be preferable to split the different elements included on IHT 100 into separate forms.
9. The guidance provided on completing form IHT 100 is unclear and confusing – in part because it is covering too many different things.
10. Acknowledgements are not issued following submission of IHT 100s – coupled with the time it takes HMRC to process them this causes uncertainty. The processing time needs to be reduced – where

clarity on the tax payable is required it is unacceptable that it can take 6 months to obtain an answer from HMRC.

Lifetime gifts to individuals

11. The annual exemption of £3,000 has not been increased since 1981. The small gifts exemption (£250 per year) and the exemptions for gifts in consideration of marriage or civil partnership (£5,000, £2,500 or £1,000, depending on the identity of the transferor) have similarly not been increased for many years.
12. These exemption limits should be increased to a more realistic level and then indexed annually. Alternatively, they could be merged into one simple (but higher) exemption covering all gifts made in a year – either as a total figure for all gifts in the year or a total figure for gifts permitted to any one individual in a year. This amount should be indexed. This would be much easier for individuals to understand and would therefore make compliance more likely.
13. The requirement to keep records of small gifts imposes a disproportionate administrative burden. In practice it is highly unlikely that proper records, particularly of small gifts, are currently being kept by many individuals. Many people will be unaware of the rules but there will also be questions of interpretation and structure: for example, are parents paying costs for a wedding reception funding a social event, incurring expenditure out of income or making a gift in consideration of a marriage – or a combination?
14. In many cases the interaction between some of the fixed exemptions, the exemption for normal expenditure out of income and the PET rules is likely to mean that even if a fixed exemption limit has been exceeded there may still be no IHT due – but disproportionate effort will have been expended to ascertain all the facts after death.
15. Putting in place realistic exemption limits or simplifying the rules by creating one simple annual exemption (set at a higher figure which would be indexed) is unlikely to result in a significant tax loss to the exchequer. Making the rules easier to understand and providing clarity would facilitate compliance and allow advisers and clients to concentrate on more significant lifetime gifts.

Business Property Relief and Agricultural Property Relief

16. HMRC Research report 478 Behavioural evidence around Inheritance Tax and reliefs was published in November 2017: <https://www.gov.uk/government/publications/research-into-the-influence-of-ih-reliefs-and-exemptions>
17. The qualitative research was commissioned by HMRC to understand the motivations, behaviours and attitudes underlying individuals' decision-making on Inheritance Tax (IHT) matters and the use of reliefs and exemptions in that process. Specifically, the objectives were to understand the decisions made by testators with agricultural or business assets when planning what to do with their estate, the influence of IHT reliefs and what beneficiaries do, or intend to do with inherited assets.
18. The qualitative nature of the research means that the findings are not statistically representative of the wider population, but it does provide some evidence to suggest that BPR and APR are not significantly distorting business decisions.
19. A key finding of the research was that testators, beneficiaries (in the future) and agents' clients most commonly planned for their estate to be kept whole and passed to a family member(s) on death. Three factors – tradition, the succession of wealth and the preservation of a business – generally underpinned these objectives. Many of the participants said that reducing IHT payable on their estate was a secondary consideration; usually in the context of supporting the three objectives.
20. In some cases, individuals planned to sell their agricultural or business assets before they died. This was usually driven by the absence of a beneficiary willing or able to take on the assets and/or by the desire to convert the assets into cash to fund retirement.
21. The research found that for all three types of interviewee - testators, beneficiaries and agents (remarking on clients' behaviour) - assets were rarely purchased specifically to make use of APR/BPR. Planning concentrated on keeping farming estates together and keeping businesses

running after death. Agents felt that the reliefs were crucial and that without them many businesses would have to be sold on death to pay the IHT bill.

22. Our members' reported experience largely reflects the findings of the research report that the reliefs do not significantly distort business decisions.
23. The differing requirements for trading across BPR, CGT gift relief and entrepreneurs' relief (ER) do cause complexity. Greater alignment could be helpful, but the precise details would need to be carefully considered to avoid unintended consequences – or adding uncertainty of treatment (linked to new rules) to the existing complexity.
24. One significant difference between BPR and ER is the requirement (in ER) for a minimum 5% shareholding. This can distort business decisions, by making entrepreneurs unwilling to seek investment in the company which could dilute their shareholding – as noted in the recent consultation on "Allowing Entrepreneurs' Relief on gains before dilution". Removing this requirement for ER would be a simplification and would more closely align the ER rules not only with those for BPR but also with other types of ER claimant (partners and employees in EMI) and with the rules for Investors' Relief.
25. However, removing the 5% requirement would have cost implications and as the OTS notes in its recent [Business Lifecycle Report](#) the cost of tax relief on claims to ER is greater than that of any of the other reliefs considered in the report. We support the OTS recommendation for a detailed review of the tax system as it operates on key events in the business lifecycle, to help maximise economic opportunities and to make the system clear and simple to understand and use.
26. We do not believe that a full merger of APR and BPR or the replacement of APR by BPR should be considered prior to completion of the detailed review of the entire system recommended by the OTS. As set out in our general comments we also believe significant changes should only be considered after Brexit. We discuss this further in our comments on the wider IHT system below.
27. As noted in our general comments agricultural policy is a devolved matter. Any proposals for reform of APR therefore need to be discussed with the agricultural departments of each devolved government.

Other areas of complexity

28. The Residence Nil Rate Band (RNRB) is overly complex and is likely to distort investment decisions by favouring the retention of wealth in the family home, in preference to investing in other assets (shares, for example). This is unlikely to be in the public interest. In many cases it will also fail to deliver on its aim – to allow individuals to pass on the family home on death – because in London and the South East the £2 million limit will often already be too low. Even where it is applicable the additional nil rate band will reduce the total tax bill on the estate – but there may still be tax payable which will require the sale of the house to meet the cost.
29. The RNRB is also unfair as it only applies to taxpayers with children – but not to others, even though they may have equal need of it. Two siblings sharing a house will be unable to access the relief – potentially meaning that after the death of one sibling, the survivor could be forced to sell their home.
30. An across-the-board increase in the £325,000 nil rate band would have been an easier, fairer solution to the perceived problem which RNRB was intended to tackle, and one which taxpayers could more readily have understood. This approach was not adopted for cost reasons – a simple increase in the nil rate band to £500,000 would have been more expensive. However, it would have been preferable to have increased the nil rate band by a smaller amount to keep the projected cost at the same level as the projected cost of RNRB.

Wider IHT system

31. It would be desirable to reform the IHT system more widely to simplify it. However, for IHT, as for other areas of the tax regime cost constraints are likely to present obstacles to genuine simplification. As illustrated by RNRB cost constraints also lead to changes being implemented in an overly complex way – which potentially creates distortions and unfairness.

32. The call for evidence suggests that one option could be to remove some exemptions to fund a lower or graduated rate or a higher NRB. On the face of it this has some appeal – but it could easily have unintended consequences, not least because of the interaction of IHT with other taxes. The system needs to be considered as a whole.
33. As noted above in its recent Business Lifecycle Report the OTS has suggested that “there is a pressing need to undertake a detailed review of the tax system as it operates on key events in the business lifecycle, to help the UK economy to maximise its opportunities and to make the system clear and simple for companies to understand and use. This might be supplemented by additional work focusing on tax complexity as it impacts business growth, including learning from the OTS reviews of VAT and small company taxation.”
34. Such a review should include consideration of the two significant IHT reliefs – BPR and APR – and their interaction with other reliefs. It might also provide a useful starting point for the consideration of wider IHT reforms.
35. A disadvantage of undertaking significant changes, as part of wider IHT reform, is that it will inevitably lead to a period of uncertainty whilst the changes are implemented, and the meaning of new legislation is clarified through guidance and judicial decisions. Brexit is currently causing uncertainty for businesses and filling the legislative timetable, so we do not think major changes to IHT (particularly APR and BPR) would be welcome in the immediate future. Whilst the present rules are imperfect they are generally understood by advisers – with problems at the margins (including with RNRB as outlined above).
36. We believe that the immediate focus should be on administrative improvements and the simplification of the lifetime gifts regime as discussed above. This would facilitate compliance and simplify one key area which causes difficulties, without creating uncertainty and unintended consequences. Post-Brexit and after the detailed review referred to above (which would look at the whole system) wider reform should be considered.