

Inheritance tax in estates

General points

Personal representatives (PRs) who deal with the estate of a deceased person are frequently required to prepare and submit a detailed account of the assets and liabilities for inheritance tax (IHT) purposes.

PRs are required to take reasonable care to ensure that the information provided to HM Revenue & Customs (HMRC) is correct. They must therefore make full enquiries to ascertain details of all of the deceased's assets and liabilities and accurate values for them.

The IHT legislation requires assets to be returned at their open market value at the date of death, or at the date of gift in the case of gifts made within seven years of the date of death. It is sometimes thought that a 'probate valuation' produces a lower result but in reality there is no such thing and a true open market valuation must be used.

Failure by PRs to include all assets and liabilities at correct values could result in HMRC determining that the IHT account had been negligently prepared. If the net value of the estate were higher than that initially reported, PRs would be liable to pay the additional IHT due on that value. In addition interest, if the extra IHT were paid later than the original due date, and a penalty of up to 100% of the underpaid IHT might be payable.

It is therefore vitally important that PRs take proper care in ascertaining the value of assets. In particular it is typically essential that advice and professional valuations are obtained for land, houses, house contents, and shares in companies or other businesses.

Particular areas which HMRC are likely to examine in detail

Specific areas where HMRC are liable to raise significant queries and professional advice should be taken by PRs at as early a stage as possible include the following:

- **Gifts with reservation of benefit**

If a deceased person had given away a property which they had then continued to occupy or benefit from, the gift would usually be treated as 'with reservation of benefit'. The property would therefore continue to form part of the deceased's estate for IHT purposes, unless it could be shown that the deceased paid a full open market rent for the benefit they received from the property.

HMRC would normally want to see evidence of the gift and the method used by the new owner of the property to ascertain the market rent for it.

- **Gifts made as normal expenditure out of income**

If it could be shown that a deceased person had made gifts out of surplus income on a regular basis, then those gifts might be exempt from IHT. However, HMRC would require much detail in order to accept the exemption.

HMRC might require PRs to go through the bank accounts of the deceased for seven years prior to the date of death to prove that there was sufficient surplus income over and above the deceased's habitual living costs. HMRC might also take a keen interest in the exact levels of gifts made and seek to deny relief if there were one year with significantly bigger gifts than other years.

- **Agricultural property relief - farmhouses**

There is 100% relief from IHT available on some agricultural property. This relief is however available only on the 'agricultural value' of the assets in question. This can particularly be an issue in relation to a farmhouse.

In most cases HMRC will argue that the agricultural value of a farmhouse is around 30% lower than its full open market value. If there were no other relief available, PRs would find that some part of the value of a farmhouse were subject to IHT even if 100% relief were available in principle. As usual, professional advice and a valuation would be essential at the outset although HMRC could still seek to negotiate over the availability of the relief and the value.

- **Business property relief – let properties and caravan parks**

There is also 100% relief from IHT available on some business property. This is essentially applicable to shares in a private trading company or interests in a primarily trading business.

The relief is often not available in relation to let properties even where they qualify as 'furnished holiday lettings' so that the management of them is treated as a trade for income and capital gains tax purposes. HMRC would be likely to deny IHT relief unless it could be clearly shown that the deceased was providing a significant level of additional services over and above the letting of the property. Similarly a caravan park might need to offer extra services, such as catering or entertainment, to qualify for the IHT relief.

In relation to the above areas, and indeed all aspects of tax, the potential taxpayer should seek advice in lifetime in order to mitigate the tax charges that may become due and prevent unexpected liabilities arising in their estate.

For further information please get in touch with your usual Ladders contact or via:

Stratford upon Avon office – 01789 293259

Henley in Arden office – 01564 792261

Cheltenham office – 01242 228370

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