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By email and by post

12 June 2018

Dear Mr Morton

**Office of Tax Simplification's "Inheritance Tax Review: Call for Evidence and Survey"**

We are writing in response to the Office of Tax Simplification's (OTS) Inheritance Tax Review (Review) published in April 2018. We welcome the opportunity to discuss the important issues raised in the Review and to express our concerns where relevant. Our comments are based on our substantive experience gained over many years within this area and client advice we have prepared.

**1. RECOMMENDATIONS: SUMMARY**

The following is a summary of some of our key recommendations, which we would like to highlight. We suggest:

- A more flexible approach to payment of Inheritance Tax (IHT). A secure charge on property within the estate could be useful where there are insufficient bank account funds to cover IHT;
- Creating an online portal where progress in dealing with IHT papers could be checked;
- Extending the ten-year IHT instalment period to avoid the need for surviving cohabitants to sell a property. To compensate, HMRC could introduce graded interest rates which reflect the period of time over which the IHT is being paid;
- Incorporating the Residence Nil Rate Band (RNRB) into the Nil Rate Band (NRB). Loss of RNRB relief can be countered through an increase in the value of the new NRB;
- Phasing in the two year rule for Agricultural Property Relief (APR) and Business Property Relief (BPR): an individual who has held assets for 23 months can then benefit from a percentage of the relief that would have applied had they survived the two year period. To compensate HMRC, a gradual introduction of the 100% application of the relief could be extended just beyond two years;
- The smaller exemptions are useful in order to avoid an overly forensic review of a deceased's spending. However, the £250 limit, marriage allowance and annual exemption have not increased for some time. An upward review of these exemptions would be helpful to reflect inflation which has a subsequent impact on spending levels.

Tax legislation is complex and inevitably this means that any associated processes will be equally complicated and sophisticated. We would urge that any drive for simplification does not detrimentally amend or remove key elements of an important IHT relief thereby rendering it less effective.

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## **2. IHT FORMS, ADMINISTRATION AND GUIDANCE (1-2)**

### **2.1 IHT Forms**

In additions to forms IHT205 and IHT400, forms we most commonly use include:

IHT 401: domicile outside the UK;  
IHT 402: claim to transfer unused NRB;  
IHT 403: gifts and other transfers of value;  
IHT 404: jointly owned assets;  
IHT 405: houses, land, buildings and interests in land;  
IHT 406: bank and building society accounts;  
IHT 407: household and personal goods;  
IHT 409: pensions;  
IHT 410: life assurance and annuities;  
IHT 411: listed stock and shares;  
IHT 412: unlisted stocks and shares and control holdings;  
IHT 416: debts due to estate;  
IHT 417: foreign assets;  
IHT 418: assets held in trust;  
IHT 430: reduced rate of IHT;  
IHT 435: RNRB claim  
IHT 436: transferable RNRB claim.

We feel the drafting of these forms could be improved. While not making detailed individual comments about every form, specific concerns include:

- Forms, such as IHT435 (RNRB claim), are overly time consuming and complex to complete, with numerous references to information required from other IHT forms. Form IHT430 (reduced rate of IHT), for example, also contains multiple boxes to compute available tax relief;
- Considerable duplication of information requested on the various forms and schedules, which could be reduced. The IHT430 (reduced rate of IHT), for example, could be automatically populated with information provided in the wider IHT papers;
- Limited technological support: We acknowledge the move towards a digitised probate application system, but feel more could be done now to improve current forms. Existing on-line probate forms could be enhanced through improved use of IT systems; content is difficult to save; forms do not cross-populate information nor do similar fields within the forms automatically populate relevant information. This drives us to use forms provided by external providers, which are more “technologically” focused and contain key characteristics we require for efficient production of the forms.

## **3. PROBATE (3)**

We find the 6 month IHT deadline can cause a number of problems which include:

- It does not take into account situations where there is unavoidable delay in administering an estate. This could be where there is uncertainty as to the identity of the last Will and searches are carried out and potential conflict situations. The ultimate beneficiaries are penalised through interest while matters are resolved;
- Client financial hardship: clients will often not have sufficient assets to pay IHT before the grant is acquired, which in turn can place considerable pressure on them to access funds during a very stressful period for them;
- Progress is often only achieved through a telephone call to HMRC, but calls are hampered by long response times or failure to answer.

To alleviate these concerns, we urge HMRC to consider a more flexible approach to payment of IHT. A secure charge on property, for example, within the estate could be useful where there are insufficient bank account funds to cover IHT. The charge could be paid off in due course once the grant has been obtained and assets have been cashed in, avoiding the early, pressing need to find funds from the estate to cover IHT costs, when they may not be easily accessible.

We would also encourage HMRC to consider greater investment in IT/technological systems to improve processes: it would be helpful for HMRC to set up an online portal to check progress in dealing with the IHT papers. Telephone enquiries may decrease and lines freed to deal with more urgent problems.

### 3.1 IHT and instalment options

The IHT instalment payment option is very important: it provides significant financial flexibility and can mitigate financial hardship. Based on our experience, it has allowed surviving cohabitees to continue living in their family home with their children after the death of their partner, with the IHT due paid from income on a year-by-year basis.

It is common for couples to be unmarried or for siblings or friends to be living together long term. We suggest the ten-year instalment period could be extended for a longer period of time to avoid the need for surviving cohabitees to sell the property, particularly if they have only inherited limited funds from an estate. To compensate, HMRC could introduce graded interest rates which reflect the period of time over which the IHT is being paid.

### 3.2 Progress of IHT papers

HMRC take a long time to process IHT papers. We have experience of instances where the shares department has said that they are waiting for the district valuer to deal with property valuation issues before the papers will be passed to them to assess. Is this how the system works? If so, could different aspects of the estate be dealt with simultaneously?

## **4. ESTATES THAT DO NOT HAVE TO PAY IHT (4-6)**

Clients are aware of both the NRB and RNRB, but we find explaining both their details and interaction can be difficult due to their complex, technical nature. The RNRB also discriminates against individuals that do not have lineal descendants. We believe the RNRB would benefit from being incorporated into the NRB. Loss of RNRB relief can be countered through an overall increase in the NRB.

## **5. ADMINISTERING AN ESTATE, RECORD KEEPING AND VALUATIONS (7-8)**

### 5.1 Executors' obligations (7)

HMRC should be given greater powers to pursue claims against beneficiaries, donees and trustees rather than executors. Executors can be unfairly penalised and this leads to delays in distributing estate assets. HMRC can also greatly assist executors through adhering to published timetables and a swift response to requests. It is important, for example, that requests for the IHT reference number and specific forms (such as IHT421) are dealt with promptly.

### 5.2 Valuers and IHT (8)

Once an appropriate, competent valuer has been identified, we will use them on a regular basis. We feel their appointment and the valuation of a taxable property will help to address any valuation concerns HMRC may raise at a later stage and thus speed up the valuation process. We do find, however, that the cost and time involved in the valuation can be disproportionate to the IHT payable. As a result, it is helpful that clients can put forward less costly estate agent valuations as some wish to minimise professional fees.

## **6. BUSINESSES (12-14)**

We advise multiple businesses, ranging from family-owned entities with long-term goals, to businesses which are to be wound down or sold. Whilst the advice we offer is unique to each structure, we find there are consistent, specific reasons that drive the decision-making process: key concerns are succession planning, family structure and characteristics, and what is best for the survival of (or successful sale of) the business. In our opinion, tax is of secondary importance to these wider issues. We believe that BPR relief is, however, vitally important to our clients when allowing for the continuity of the business down the generations.

### **6.1 Transfer or sale of the business (12a)**

In most cases, tax does not drive or distort the decision to sell or transfer a family business to another vehicle or directly to the next generation. It may affect the timing or the structure used, but even then, will be subordinate to questions of control and the seamless transfer of the business to new ownership.

### **6.2 Structure of the business (12b)**

Tax is only one factor that influences how a business is structured. Discussions may be held, for example, with regard to holding non-trading assets in separate entities to preserve BPR and the IHT implications of this decision. There would, however, also be a strong asset protection element to the business structure ultimately chosen by the client.

### **6.3 Choice of business vehicle (12c)**

A family business is usually already in a structure, whether that be a partnership or a company, at the point when we are appointed to advise. We find that IHT reliefs are rarely the key issue when deciding the choice of business vehicle or any potential restructuring of that vehicle. Clients place far greater emphasis on issues such as the income tax and capital gains tax (CGT) treatment of the structure, whilst operating, its commercial attractiveness and on limiting liability for those involved in its management as partners or directors.

### **6.4 AIM investment (12d)**

We acknowledge that beneficial IHT treatment is certainly an attraction for investing in unlisted trading companies through AIM. Our experience dictates, however, that clients are as concerned with investment performance and level of risk, together with maintaining a balanced portfolio of share investments, as with the IHT tax advantages provided by AIM investment. For this reason, any strategy along these lines will only ever form a small part of the client's overall asset base.

### **6.5 Complexity and reform of business reliefs (specifically CGT, BPR and entrepreneurs' relief) (13)**

The whole tax system is complex but we acknowledge that different taxes and reliefs are aimed at, and apply in, different circumstances. The tax system should reflect these differences both in the value of available reliefs and their flexibility. With CGT, for example, our clients are able to choose when, during their lifetime, they make a gift (with some limitations), whereas with IHT on death this ability to choose is absent. We would urge the Review to consider these differing factors before attempts to remove perceived differences and inequalities are implemented for CGT and IHT reliefs available to businesses.

### **6.6 BPR: proposed changes and amendments (14)**

We believe that changing the criteria for BPR qualification (eg to consider the size of a person's business interest or how long it is held after death) would add additional layers of complexity. We feel these changes are unnecessary and should be rejected. We also remind

the Review that BPR relief is vitally important to our clients when allowing for the continuity of the business down the generations.

## **7. FARMING BUSINESSES (15-17)**

Based on our experience, we believe the key reason clients request estate planning for their farming or business estates is for succession purposes. Farming can be financially challenging and farmers do not always have a substantial income stream to rely on. As a result, we find a significant number of our farming clients focus on the commercial aspects of the business first including land diversification and existing farming arrangements to ensure they have sufficient income to support their lifestyle. Most farmers are also from farming families: they inherited the farm and expect to be able to pass it on to the next generation. It is these succession issues that drive the future of the farm. Taxation questions are secondary to these key concerns. However, without APR that transfer of the farming business down the generations would be impossible.

### **7.1 Transfer or sale of the farm (15a)**

Succession issues are the key factor in determining the sale or transfer of a farm and its structure. Most farmers wish to ensure that the farming members of the next generation can succeed to the farm. IHT implications are considered where, for example, the land has developmental value (and therefore the APR is low) or the farmhouse does not qualify for APR. The desire for a successful transition of the farm business to the next generation is paramount, but APR allows this to happen.

### **7.2 Farming arrangements (contracting, licensing or letting land) (15b)**

Most farmers typically make external arrangements relating to the farm and its management based on commercial rather than tax concerns. Help is obtained, for example, where there is no one in the next generation to assist and increasing age means more support is required. We find, with a large majority of clients, that these farming arrangements are put into place and tax advice sought after their creation. The type of farm involved can also influence the nature of the arrangement (more sizable farms for example tend to require more assistance and formal arrangements to manage land).

### **7.3 APR: inhabitants and use of farmhouse (15c)**

Tax issues will influence decisions as to who occupies the farmhouse, especially if it is likely to qualify for APR. Other issues of importance include the size, needs and accommodation requirements of family members.

### **7.4 Farm: choice of vehicle and structure (15d and e)**

We do not believe that tax planning distorts or imbalances decisions about the vehicle used or structure adopted for a farm. Farming businesses are commercial operations and most need to diversify simply to make a living. Succession and tax both influence the ownership and structure of the diversification. It is common in our experience, for example, for a farm to be handed on to the next generation whilst keeping the diversified business to produce retirement income.

### **7.5 APR and the definition of a farmhouse (16)**

It is very difficult to provide one national, simplified definition of a farmhouse. Its characteristics differ throughout England and Wales from large landholdings with modest farmhouses in East Anglia, for example, to small landholdings with expensive houses in Surrey.

Equally, property conditions may vary due to investment and use over the years. Simplifying characteristics for this test could lead to unfairness: two very different properties may be targeted where only one is meant to benefit as a "genuine" farmhouse.

## 7.6 Merger/reform of APR/BPR (17)

We acknowledge there are complexities in the interaction of APR and BPR, but as we have already stated, different taxes and reliefs should target assets to reflect the unique issues associated with these assets and their ownership. We remind the Review, that both BPR and APR are vitally important to our clients, when allowing for the continuity of a business or the successful succession of a farm passing down the generations.

We feel a merger of the two reliefs or indeed a replacement of APR solely by BPR would lead to greater complexity and unfairness: farms are unique businesses and require specific reliefs to ensure their ongoing success and continued contribution to the UK economy. We would also urge the OTS to consider:

- Phasing in the two year rule for APR and BPR: an individual who has held assets for 23 months can then benefit from a percentage of the relief that would have applied had they survived the two year period, but would benefit, for example, to a greater extent than someone who had held the relevant asset for 14 months. To compensate HMRC, a gradual introduction of the 100% application of the relief could be extended just beyond two years.
- Providing more detailed guidance on the application of APR/BPR in specific situations. A review or simplification of BPR's application to a group of companies would be welcome as long as the commercial considerations for structuring are taken into account. We appreciate existing updates to HMRC's guidance, but find BPR's application becomes increasingly complex where multiple levels of holding companies and sub groups exist or where a holding-company is engaged in mixed activities (eg both trading and investment).

## 8. **CHARITABLE GIVING (18)**

We feel the charitable 10% exemption is particularly complex and difficult to explain to clients. The component aspect is not easy for them to understand. Due to the complexity of this relief, professional costs in reviewing and dealing with it are counterproductive to the saving and the underlying reason to benefit charity.

## 9. **WIDER IHT SYSTEM (19-20)**

As part of its wider drive for IHT simplification and to encourage greater transparency and equality throughout the IHT tax system, we would urge the OTS to consider the following additional issues:

- The smaller IHT exemptions are useful in order to avoid an overly forensic review of a deceased's spending. However, the £250 limit, marriage allowance and annual exemption have not increased for some time and an upward review would be helpful to reflect inflation, which has a subsequent impact on spending levels;
- Extending the two-year threshold for normal expenditure out of income after which income may become identified as capital. This would simplify the legislation and add additional clarity and flexibility for our clients;
- IHT exemptions should be extended to cohabitants who have been living together for a specified period of time, including couples, friends or family members who live together (siblings). HMRC should be allowed to take charges on estate assets as opposed to the upfront payment of IHT pre grant.

We do hope our comments have been helpful. Please contact us if you have any further questions.

Yours sincerely

**Sarah Robinson, Senior Knowledge Lawyer**