



Association of Accounting Technicians (AAT) response to the Office of Tax Simplification “Inheritance Tax Review: Call for evidence”

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the OTS “Inheritance Tax Review: Call for evidence”, published on 27 April 2018.
- 1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.

2. Executive summary

- 2.1. **Inheritance Tax (IHT) receipts are rising rapidly, raising £5.3 billion over the past year to the end of February 2018, a record high and a rise of 13% year-on-year.**
At the same time, only 4% of estates pay IHT. This fact needs to be more effectively communicated to the public as many more than 4% believe they will be affected by IHT and act accordingly.
- 2.2. **IHT must ordinarily be paid before probate is granted, preventing assets from the estate being used to pay the tax.**
This catch-22 situation can create considerable cash-flow difficulties for some. Extending the more relaxed treatment of cash savings to shares and offering a time-to-pay facility would go some way to easing this problem.
- 2.3. **The Residence Nil Rate Band (RNRB) was a convoluted way of meeting a manifesto pledge but two general elections later, with criticism of the policy widespread, there appears to be no real reason not to remove this complexity and address the issue by simply increasing the general nil rate band.**
- 2.4. **The £1bn cost to the taxpayer of tax relief currently given through Business Property Relief (BPR) and Agricultural Property Relief (APR) should be reduced.**
This can be done by focussing the reliefs on businesses and farms instead of incentivising assets to be held primarily, and often purely, for tax reasons.
- 2.5. **The exemption that permits certain AIM companies to benefit from BPR - making the shares exempt from IHT if they are held for at least two years and at death - is an anomaly that should be ended.**
- 2.6. **The charitable exemption is an unnecessary complexity that adds little, if any, value.**
There is no evidence to suggest the exemption has led to an increase in charitable giving since it was introduced six years ago. As a result, AAT suggest that the OTS give serious consideration to recommending it be removed.
- 2.7. **The £325,000 nil rate band (£650,000 for couples) should not be increased.**
This is because most families are adequately covered by this band, ensuring only the wealthiest (4% of all estates) are liable for IHT.

3. AAT response to the call for evidence

- 3.1. The following paragraphs outline AAT's response to the proposals outlined in the Call for evidence. We have only listed those questions where AAT has a comment to make.

Question 2: In general, the deadline for payment of IHT is 6 months after death, whilst the deadline for submitting the relevant IHT form is 12 months after death. Please describe any problems or issues that arise because of this.

- 3.2. It is only once probate has been granted that assets can be distributed. This means that tax must be paid, the money from the estate is not available to pay it and will not be so until the tax is paid. This catch-22 situation can create considerable cash-flow difficulties for some.
- 3.3. Where the estate includes cash savings that would cover the bill, the executor can make a payment directly to HMRC from the bank or building society that holds the savings. However, executors with no training in this area, i.e. non-professionals, are likely to be unaware of this option.
- 3.4. Where there are insufficient savings then executors can either pay out of their own pocket, where they have sufficient money to do so, or a bank, building society or other form of loan can be arranged – meaning there will be an interest cost to the executor.
- 3.5. Where the assets are shares, these cannot ordinarily be sold to pay the IHT liability. Although the sale cannot take place without grant of probate, in some cases HMRC will permit this to take place providing they are effectively treated as the priority "creditor". However, this is entirely reliant on the discretion of HMRC who will consider any such application on a case-by-case basis. AAT questions why shares should be treated any differently to cash or why what is acceptable for some is not acceptable for others. It would be far better to take a consistent and more equitable approach to this issue.
- 3.6. Where the asset is property, IHT can be paid in instalments covering a period up to ten years. Again, this is not widely known and is unlikely to be taken advantage of by non-professionals or those who do not seek advice, meaning considerable and perhaps unnecessary concern is caused. Of course, interest is payable on these instalment payments.
- 3.7. With specific regard to deadlines, it would make more sense if the deadline for payment and for submitting the relevant forms were aligned and that both were 12 months after the death. This would enable more time for those struggling with cash flow issues to make financial arrangements.

Question 3: Does this process create practical difficulties? Bearing in mind the benefit of this mechanism, what could be done to address any such difficulties? To what extent does the instalment payment option where the IHT is attributable to certain assets in instalments help mitigate any issues?

- 3.8. The main practical issues arising from this process have already been detailed above (3.2-3.6).
- 3.9. Offering a short-term, easy to arrange "time to pay" type facility as HMRC does in many other instances of hardship is one potential means of alleviating the above detailed problems.
- 3.10. The existing HMRC instalment payment option is of some help but many are unaware of its existence and interest remains payable.

Question 4: Are there any disproportionate administrative or compliance burdens in establishing whether the value of the estate is below the NRB, or where the spouse exemption applies? How could these be reduced?

- 3.11. AAT does not believe there are any disproportionate burdens associated with establishing whether the estate's value is below the NRB or, in the case of UK resident spouses, determining whether the spousal exemption applies.

Question 5: Could the guidance on www.gov.uk be improved to support people handling estates on which no IHT will be paid? If so, how?

- 3.12. The guidance at <https://www.gov.uk/inheritance-tax> is mostly clear and helpful although AAT recommends making minor changes to make it easier to access and more intuitive.
- 3.13. AAT also suggests emboldening or highlighting the section that reads:
- “There’s normally no Inheritance Tax to pay if either: the value of your estate is below the £325,000 threshold or you leave everything to your spouse or civil partner, a charity or a community amateur sports club”*
- 3.14. Alternatively/additionally a pop-up box alerting visitors to this fact could be considered.
- 3.15. While “digital” channels might work for most users they do not work for all. OTS should therefore closely examine the efficacy of other channels to deliver information and services for IHT.

Question 6: Are there other steps that government could take to raise awareness of the NRB to reduce anxiety around liability to IHT for people who don’t have to pay it?

- 3.16. Yes. Government could and should work with the likes of AgeUK, Saga, moneysavingexpert.com and Citizens Advice to disseminate clear and consistent messaging on this issue.
- 3.17. Likewise, Government could and should work with professional bodies, covering the financial advice, accounting and legal sectors, to continuously encourage the promotion of how IHT works so that members can in turn pass this information on to their clients.
- 3.18. There is a potential role for the savings and pension industry to play here too. With most of deaths in the UK coming after the age of 65 - meaning most who die are in receipt of a pension - pension providers could provide some very basic IHT information within annual pension statements.
- 3.19. A lack of awareness and understanding is compounded by the introduction of additional layers of complexity such as the Transferrable NRB, introduced in 2007, and the Residence NRB (RNRB), introduced in 2017.
- 3.20. These changes afford opportunities for estates to significantly reduce their exposure to IHT, but neither are widely understood by non-professionals. Simplification would help to increase public knowledge and understanding whilst substantial simplification would mean the public would not have to rely on professional advice except in the most challenging of circumstances.

Question 7: What, if anything, could be done to help executors administer an estate and fulfil their obligations?

- 3.21. It should be made clear that a solicitor is not always necessary to administer an estate as it is a popular misconception that legal assistance is required.
- 3.22. Simultaneously, it should be highlighted that complicated cases e.g. where the person who died left money or property in a trust, owned land or property abroad or where the will is in dispute, would certainly benefit from legal advice and that such fees can be taken from the estate rather than having to be paid upfront.
- 3.23. Whilst recognising it may be beyond the scope of this Call for Evidence, AAT would like to draw attention to 2017 research by the Legal Services Board, which found that only 18% of solicitors that dealt with probate displayed their prices online and that this figure was identical in 2015 suggesting a lack of willingness to change¹.

¹ Legal Services Board, 2017:
http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2017/20171114_LSB_Publishes_Latest_Research_Into_The_Price_Of_Legal_Services.html

- 3.24. This, coupled with a mixture of charging per hour, an inclusive price and in some cases a vague estimation, means that consumers cannot easily shop around and compare prices.
- 3.25. Requiring solicitors to have a consistent fee structure and for this to be advertised would go a long way to increasing trust in what is increasingly seen as an area of "rip-off" fees.
- 3.26. For the increasing number of individuals who decide to administer the estate themselves, the recent establishment of an online application system from the Probate Registry is welcome as this enables applicants to complete an online statement of truth (removing the need to swear an oath in person), to pay fees online and to save and return to applications to enable applicants to check details etc. and not have to commence the process all over again.
- 3.27. In contrast, only some IHT forms from HMRC can be completed online e.g. IHT205. Some are available online and can have text entered but then need to be printed off and returned e.g. IHT217 and PA1 although rather unhelpfully neither contains the address to which it must be returned. Others are available online only as PDFs which must be printed, completed by hand and returned by post and some, such as the 16 page IHT400 can have limited details completed online, the rest must be completed in blue or black ink and returned by post – again the address does not appear on the form, which means a lengthy search is required to establish where it should go.
- 3.28. Digitising all IHT paperwork would certainly help executors with the administration process.

Questions 9 & 10: Are there any aspects of the interaction between the thresholds and exemptions relating to lifetime gifts that you find especially distortive or complex to understand and apply? How, if at all, should these rules be simplified? What could be done to improve public understanding of the rules? Have you found that the joint liability of the estate and the person receiving the gift can cause problems for executors or HMRC?

- 3.29. Taper relief on gifts is unnecessarily complicated, benefits only the wealthiest in society and relies on a considerable degree of luck i.e. when the individual dies, to determine the amount paid. In the interests of simplicity, AAT suggests the government give serious consideration to removing taper relief.
- 3.30. Likewise, exemption for gifts on marriage, exemptions for gifts generally, gifts to political parties, small gifts exemption and so on, are all reliefs that the public are largely unaware of, require a degree of planning and will usually only be taken advantage of if professional advice is given.
- 3.31. There would be some complaints from the wealthy and from advisers but, scrapping these exemptions would not cause considerable consumer detriment, would save the taxpayer money and would add to a simplified IHT landscape that can be more easily understood by all.

Question 11: How, if at all, could the monetary thresholds and the various lifetime exemptions be simplified?

- 3.32. Inheritance Tax could be, should be and once was, a relatively simple tax. However, the numerous amendments introduced over the years, especially since the turn of the century, have introduced a wealth of additional complexity.
- 3.33. The residence nil rate band (RNRB) is perhaps the most obvious such area of complexity. The complexity here not only involves the band having a £25,000 increase each year to 2021, followed by inflationary increases, but the additional complexity of a tapered withdrawal for estates with a net value over £2m (at a withdrawal rate of £1 for every £2 over this threshold).
- 3.34. RNRB was a convoluted way of meeting a manifesto pledge but two general elections later, with criticism of the policy widespread, there appears to be no real reason not to remove this complexity and address the issue by simply increasing the general nil rate band.
- 3.35. Further suggestions for simplification are detailed in the response to questions 19 & 20 below.

Question 12: How, if at all, does the IHT framework, including the related tax considerations set out above, make business decisions challenging? For example, does it affect or distort decisions regarding:

a) whether to sell or transfer a family business to another vehicle or directly to the next generation during lifetime or wait until death,
b) the structure of the business (for example, how to hold non-trading assets),
c) the choice of business vehicle (for example a corporate entity, partnership, unincorporated business), or
d) investment in unlisted trading companies (including those traded on the alternative investment market (AIM))?

- 3.36. Genuine users of Business Property Relief (BPR) are likely to have some awareness of BPR's existence but, in general will rely on advisers to fill in the details.
- 3.37. Of course, many users of BPR do not own a business in just the same way that many users of Agriculture Property Relief (APR) are not farmers. The £1bn+ of tax relief currently given through BPR and APR would likely be reduced if it were properly focused on businesses and farms instead of incentivising particular assets to be held primarily, and often purely, for tax reasons.
- 3.38. Although AAT disagrees with much of the recent Resolution Foundation report² relating to inheritance tax, it does agree with their proposal to restrict BPR to small family businesses where the beneficiary receives at least 25% of the business and the donor had a demonstrable working relationship with the company.
- 3.39. Likewise, restricting Agricultural Property Relief (APR) by ensuring at least 80% of the beneficiary's assets comprise of agricultural property is an idea with merit that should be explored further.
- 3.40. AAT is not aware of any evidence that the IHT framework impacts with any significance on the structure of a business or choice of business vehicle.
- 3.41. The exemption that permits certain AIM companies to benefit from BPR - making the shares exempt from IHT as long as they are held for at least two years and at death - is an anomaly that should be ended.
- 3.42. BPR was introduced in 1976 to make sure successful family businesses did not have to pay large tax bills to retain control of the business. BPR was not designed as an avoidance measure or to promote AIM listed shares. There is no sound basis for allowing such an exemption to continue and AAT therefore recommends this also be removed.

Question 13: Do the different requirements for trading across BPR, CGT gift relief and entrepreneurs' relief cause complexity and, if so, how could this be addressed? Are there any other inconsistent definitions or approaches either within IHT, or across IHT and CGT and if so, does this cause complexity? Do you have any other suggestions as to how to remove complexity around the interaction between CGT and IHT?

- 3.43. Generally speaking, the current complexities relating to the interaction of CGT, IHT, gift relief and entrepreneur's relief are well understood by professionals e.g. accountants and financial advisers but far less so, if at all, by the general public.
- 3.44. The simplest means of removing complexity around CGT and IHT would be to scrap IHT and rely solely on CGT as happens in other countries, perhaps most notably Australia (see 3.65).
- 3.45. AAT accepts that the political appetite for such radical reform in the UK may no longer exist and as a result suggests that the OTS give careful consideration to aligning definitions instead.

² Resolution Foundation, Passing on, May 2018:
<https://www.resolutionfoundation.org/publications/passing-on-options-for-reforming-inheritance-taxation/>

- 3.46. AAT recognises that this is easier said than done given the underlining statutory differences and different tests of applicability. Furnished holiday lettings are a frequently used example to highlight the differences as this is treated as a trade and qualifies for some tax reliefs (income tax and CGT), but as an investment activity for other taxes, and therefore does not qualify for IHT relief.
- 3.47. Nevertheless, there is certainly room for more closer alignment.

Question 14: The availability of BPR is not generally dependent on the size of a person's interest in a business or holding it for any period after death. Does this feature of BPR add to or reduce complexity?

- 3.48. In its strictest sense, the fact this feature does not require the performance of calculations to prove that an arbitrary threshold has been crossed reduces complexity. However, complexity alone should not be the test. Instead, complexity, equity and fairness should all be equal considerations.
- 3.49. Although AAT disagrees with much of the recent Resolution Foundation report³ relating to inheritance tax, it does agree with their proposal to restrict BPR to small family businesses where the beneficiary receives at least 25% of the business and the donor had a demonstrable working relationship with the company.
- 3.50. Likewise, restricting Agricultural Property Relief (APR) by ensuring at least 80% of the beneficiary's assets comprise of agricultural property is an idea with merit that should be explored further.
- 3.51. In summary, the £1bn+ of tax relief currently given through BPR and APR would likely be reduced if it were properly focused on businesses and farms instead of incentivising particular assets to be held primarily, and often purely, for tax reasons.

Question 18: How well do you think the charitable exemption and the lower rate of tax on death is understood by advisers or the public? Please tell us about any areas of complexity in the application of this rate, or the charitable exemption, along with any suggested improvements.

- 3.52. Accepting that advisers are likely to be well versed in and understand the charity exemption, those who retain them will also be well informed. Conversely, it is less likely that those who do not retain advisers will be so aware.
- 3.53. Even if well understood, more than half of those who die in the UK fail to make a will. Of those that do leave a will, a meagre 6.2% contain a gift to charity⁴ and only 4% of all estates are liable to IHT. This would suggest that the charitable exemption is an unnecessary complexity that adds little, if any, value.
- 3.54. Although HMRC figures show that the cost of IHT relief for charitable donations rose by 79 per cent to £840m in the five years to April 2017 i.e. since the 2012 introduction of the charitable exemption, this substantial additional cost to the taxpayer does not equate to any more charitable giving than would have been the case otherwise. It simply means that some estates are gaining substantial tax savings. AAT therefore recommends that this exemption be removed.

³ Resolution Foundation, Passing on, May 2018:
<https://www.resolutionfoundation.org/publications/passing-on-options-for-reforming-inheritance-taxation/>

⁴ Smee & Ford, 2016

Question 19: Please tell us about any other areas of complexity in applying any IHT rules, reliefs or thresholds not already mentioned in your response, along with any suggested improvements. You may, for example, wish to comment on the residence nil rate band, the IHT treatment of trusts, the IHT treatment of personal pensions and life insurance products, or the conditional exemption for certain works of art or heritage assets.

Question 20: Do you think that the IHT system should be reformed more widely to simplify it? If so, how? Should some IHT exemptions be removed to fund a lower or graduated rate or a higher NRB? If so, which ones? Are there any useful lessons that could be learned from other countries? If so what, and from which countries?

- 3.55. There are numerous possibilities to reform IHT for the better. Changes that would achieve simplification, enhance consumer understanding and save the taxpayer money including dealing with taper relief, AIM shares and the charity exemption (as detailed at 3.41 and 3.42).
- 3.56. Numerous commentators have recommended that the £325,000 NRB be increased simply because it has not increased in line with inflation since 2009. There are no sound economic reasons to do so.
- 3.57. The average house price in January 2018 was £225,621 (UK House Price Index) and the average UK family - not individual - has a total of £3,134 in savings and investments and 25% of the country has less than £100 in savings and investments (Aviva, 2017).
- 3.58. In addition, new provisions allowing individuals and married couples to pass on their main home with a smaller tax liability worth £100,000 in 2017-18, £125,000 in 2018-19, £150,000 in 2019-20, and £175,000 in 2020-21 (the Nil Rate Residence Band) are far more than any inflationary linked increase would achieve.
- 3.59. For the majority, the £325,000 threshold (£650,000 for a married couple) is more than sufficient, especially when the above property allowances (3.53) are factored in.
- 3.60. Unlike most commentators, AAT therefore recommends that the NRB be maintained rather than increased.
- 3.61. Looking at the system more widely, most people are completely unaware of the Pre-Owned Assets Tax (POAT) and it is not well understood by those that are aware of it, and the first awareness that most will have is when completing the IHT compliance forms after a death i.e. when it is too late to take action to avoid or minimise and when arrears and interest payments may become due.
- 3.62. POAT also contributes additional and unnecessary complexity for very little financial return.
- 3.63. For the reasons set out at 3.61 and 3.62 AAT recommends that POAT should be scrapped.
- 3.64. As an alternative to IHT, some commentators have suggested that tax should be levied on the donee rather than the donor. In addition to much increased collection and compliance costs, such a step would be more complex than the current system – achieving the opposite of the OTS objective of increased simplification. There is also a high degree of uncertainty about what level of tax receipts this would generate. Furthermore, it may give rise to the types of significant inequity that such a tax generates in countries like Japan (see below at 3.67). As a result of these considerations alone, AAT does not recommend switching to a tax on recipients instead of estates unless of course the far more radical approach of scrapping IHT without replacing it and therefore leaving CGT to apply in the normal way as at present.
- 3.65. Finally, with regard to international examples, Australia is certainly worthy of note given inheritance tax was abolished in the 1970's. Instead, the Australians rely solely on Capital Gains Tax. A far simpler and some would argue, more meritocratic approach to taxation. There is also a precedent for a major UK political party arguing for such a change too, as recently as the early 1990's Conservative Chancellor John Major committed to making such a change as soon as he felt it affordable to do so.

3.66. In contrast, Japan has perhaps the most punitive regime in the world with a 55% tax rate and a relatively low threshold of 30m Yen (£200,000). Japanese inheritance tax is also applicable to long term foreign residents (resident for 10 years or more of the previous 15 years) and because it is payable by the recipients of the property, rather than the person transferring the property, non-residents can unwittingly end up with a Japanese inheritance tax liability.

4. **About AAT**

- 4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are more than 4,250 licensed accountants who provide accountancy and taxation services to over 400,000 British businesses.
- 4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. **Further information**

If you have any queries, require any further information or would like to discuss any of the above points in more detail, please contact Phil Hall, AAT Head of Public Affairs & Public Policy at:

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