Kingston Smith

Inheritance tax Liabilities

Inheritance tax (IHT) is charged on an individual's net estate, i.e. the total value of assets less liabilities owed by the estate. The liabilities are usually deducted from the assets that they relate to.

For example, a loan secured on a property is deducted from the value of that property and the net amount is used when calculating the total value of the estate for IHT purposes.

In the majority of cases this has not been an issue. However, where an IHT relief is already available on property, such as business property, agricultural property or woodlands, it can mean that some of the IHT relief is wasted. This results in an increase in the amount of the individual's estate liable to IHT.

The new rules will also impact loans to connected parties which are written off at death and non-UK domiciled taxpayers who have borrowed money against UK property and moved it offshore.

The IHT reliefs concerned

Subject to certain conditions:

- Business property relief (BPR) can reduce the transfer of value for IHT by 50% or 100% when business property is given away.
- Agricultural property relief (APR) can reduce the transfer of value for IHT by 50% or 100% when agricultural property, such as, farmland buildings are given away.
- If an individual owns woodland, the value of the timber is excluded from their estate. The woodland might also qualify for APR or BPR, if it is part of a working farm or business.

Example:

X's estate comprises a house worth £2.5M. There is therefore a potential IHT liability of £1M on this property (£2.5M x 40%).

X also buys a farm for £1.5M, funded with a loan.

X had the loan secured on his house instead of the farm to increase the business asset value and the BPR claim.

	Business property (Farm)	House
X owns a house		£2.5M
Borrows to buy a farm	£1.5M	-£1.5M
Net estate	£1.5M	£1M
APR	-£1.5M	
Taxable estate	£Nil	£1M
IHT @ 40%		£400K
Saving		£600K

Following Royal Assent

HM Revenue & Customs have announced that restrictions will be introduced in Finance Bill 2013 to limit the deduction of liabilities from an individual's estate, when calculating the value transferred on deaths and chargeable lifetime transfers occurring after Royal Assent.

This measure is partly being implemented to target loans to acquire assets that benefit from IHT reliefs. Therefore, existing arrangements in place to avoid the loss of IHT reliefs will now be caught.

Example of position following Royal Assent

	Business property (Farm)	House
X owns a house		£2.5M
Borrows to buy a farm	£1.5M -£1.5M	
Net estate	£Nil	£2.5M
APR	£Nil	
Taxable estate	£Nil	£2.5M
IHT @ 40%		£1M

Following Royal Assent the liabilities will only be deductible in the estate where the creditor is actually going to be repaid.

IHT planning

IHT planning is commonly overlooked or left until it is too late. This can be because it is considered that planning will involve transferring assets, but often reorganising assets can be effective.

If you might be affected by this change to the rules, reviewing your estate planning has never been so important.

Based on Kingston Smith LLP's knowledge of inheritance tax liabilities as of April 2013.
Updated November 2016 .