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PayLessTax

2021 IHT Edition

Death - Taxes - Business

There will be many people who either own a business interest at death or gifted it away to somebody, or to a Trust, within seven years prior to their demise.

The commonly held belief is that although **the value of the business will form part of the deceased's Estate for inheritance tax (IHT) purposes it will nonetheless attract what is called business property relief (BPR) resulting in no IHT arising on the business asset**.

For example:

Tom had run his sole trader printing business for over 20 years, when he sadly passed away. The business is worth £300,000. This should attract 100% BPR resulting in an IHT saving of up to £120,000.

However, be very careful as the BPR tax legislation has many potential traps, which could be triggered, resulting in a nasty surprise for whoever deals with your Estate upon death. **This in turn could mean that there is less to be distributed out to your chosen beneficiaries**.

Here are just some of those possible pitfalls:

► **If you personally own an asset such as land, buildings or machinery, which you allow the business to use, then only 50% of the value of it will attract BPR**. If that business is a company, then you must have control of that firm to even obtain the 50% relief.

► **If the business is basically an investment one then no BPR would be due**. If a business is a mix of trading and investment then it is important that the business, as a whole, is mainly a trading one. If so, BPR may then possibly be claimed but only against the trading value of the business.

► There is often a practice in place for **partners or shareholder directors to enter into a buy and sell agreement**, whereby, in the event of one of them dying pre-retirement, the deceased's representatives are obliged to sell and the survivors to purchase, the deceased's business interest or shares. **If this is deemed by HMRC to be a binding contract for sale then no BPR would be due**. A cross option agreement may be more appropriate.

► **If you held a business interest for less than two years then potentially no BPR would be due**.

► If you gifted away a business interest to someone and died within seven years of doing so, the value of it, as at the date of the gift, would come into your Estate for IHT purposes. **To attract BPR, the recipient would normally need to have retained the business interest up to the date you died and the asset must have maintained its business status**.

For example:

Carol gifted her longstanding hairdressing salon to her daughter, Louise, who had recently trained as a hairdresser. The business is worth £150,000.

Three years later Carol sadly dies. The salon business is now worth £200,000. As long as Louise has not sold the business, then Carol's estate should be able to claim BPR on the value of the business as at the date of transfer i.e., £150,000.

If Louise sold the business before Carol's death it could increase the Estate IHT bill by up to £60,000.

TIP... **Where the farming of land comes into the equation, it may be possible to claim BPR on top of Agricultural Property Relief. If you would like us to review your BPR position please do not hesitate to contact us.**

Home is where the IHT value is

A person's home has a high degree of emotional value attached to it due to the memories which engulf its bricks and mortar. It is also where the greatest financial value lies.

Government statistics state that, since April 2009, the average UK home has increased in value by over 63%.

It is a pity that the inheritance tax nil rate band has remained stubbornly at £325,000 throughout that period and will continue to do so until at least April 2026!! As a result of this, more and more people are being dragged into the inheritance tax (IHT) net, triggering a 40% IHT charge on death.

There is some solace in the form of the Residence Nil Rate Band relief (RNRB) which stands at £175,000. This will also remain at that level until April 2026. If eligible, that is **a potential IHT saving of £70,000 per person (£140,000 for a married couple or civil partners)**.

What are the usual criteria for a deceased estate to be able to claim RNRB?

► The deceased should normally own a residence at the time of death. They can nominate their main residence or even a holiday home if that is more beneficial. It is important that your Wills clearly stipulate this.

► If the person has downsized over the years, it may be possible to nominate that earlier residence to obtain the maximum RNRB.

► **The property should be passed down to their lineal descendants** (or their spouses, as long as they have not remarried at the time). This could be children, grandkids, stepchildren, foster or adopted children, for example.

► **If one spouse passes away first and transfers their share of the property to the surviving spouse, it is possible for their RNRB to go across as well**. This potentially enables the surviving spouse to have two lots of RNRB (£350,000) to be utilised on their subsequent death, assuming the residence is transferred to their lineal descendants.

Be very careful, for every £2 a deceased's estate is over £2 million, £1 of RNRB is lost.

For example:

► Tom is married to Mary. He sadly passes away in December 2021.

► The value of his estate (including his half share of their residence) is £1.4 million. On death he transfers everything over to Mary.

► Mary dies in June 2022 and passes the property to their children.

► Her estate is potentially entitled to two lots of RNRB, Tom's and her own, totalling £350,000. However, Mary's estate is now worth £2.8 million. This is in excess of the £2 million threshold.

► No RNRB will be due, resulting in an additional £140,000 of IHT to pay.

When working out the value of the Estate for RNRB purposes, you have to add back the value of the business or agricultural asset which may have attracted Business Property Relief (BPR) or Agricultural Property Relief.

For example:

Fergus, a single man, owned, prior to his death, £1 million of AIMS stock. The rest of his Estate, consisting of his house and £350,000 in various bank accounts, was worth £1.35 million.

He was passing his house down to his daughter Isabelle. As Fergus had owned the AIMS stock for over 2 years that attracted a 100% BPR, an IHT saving of £400,000.

However, for calculating the RNRB we have to add back the value of the AIMS Stock.

This takes the value of his Estate, on death, back up to £2.35 million, £350,000 in excess of the threshold of £2 million when the RNRB starts to be tapered away. In this case it reduces from £175,000 to nil costing the Estate £70,000 in inheritance tax.

TIP...

If Fergus, in that example, had gifted away the £350,000 the day before he died, it would have saved his Estate £70,000 IHT as the RNRB would have been reinstated. A regular review of the value of a person's estate (or combined estates where married couples/civil partners are involved) should be carried out so that planning can be considered to maximise the RNRB where possible. Please do not hesitate to contact us if you would like to put this in motion.

A Farmer's Dying Wish

A landowner who has farmed their land or who has let it to a tenant farmer, will hope that, come the day of reckoning, they can pass that land, with the buildings on it, down to their loved ones with the minimum amount of death taxes to fund from the Estate, thanks to an inheritance tax (IHT) break known as Agricultural Property Relief (APR).

Unfortunately, the tax rules surrounding this relief are not clear cut. There are numerous factors to consider such as:

► **Does the person actually own agricultural land or pastures**? If not, then APR will fall at the first hurdle.

► What is the make-up of the land? For example, does it consist of land, woodlands, farm buildings and a farmhouse?

► **What has the land been used for**? Producing food and wine for human consumption, for example, may attract APR as would a stud farm, but not a livery stable or a fish farm where fish are reared for sport.

► **Has the landowner been farming the land? If so for how long have they been doing so**? In this scenario, the person normally would have had to farm the land for at least two years to attract APR on death.

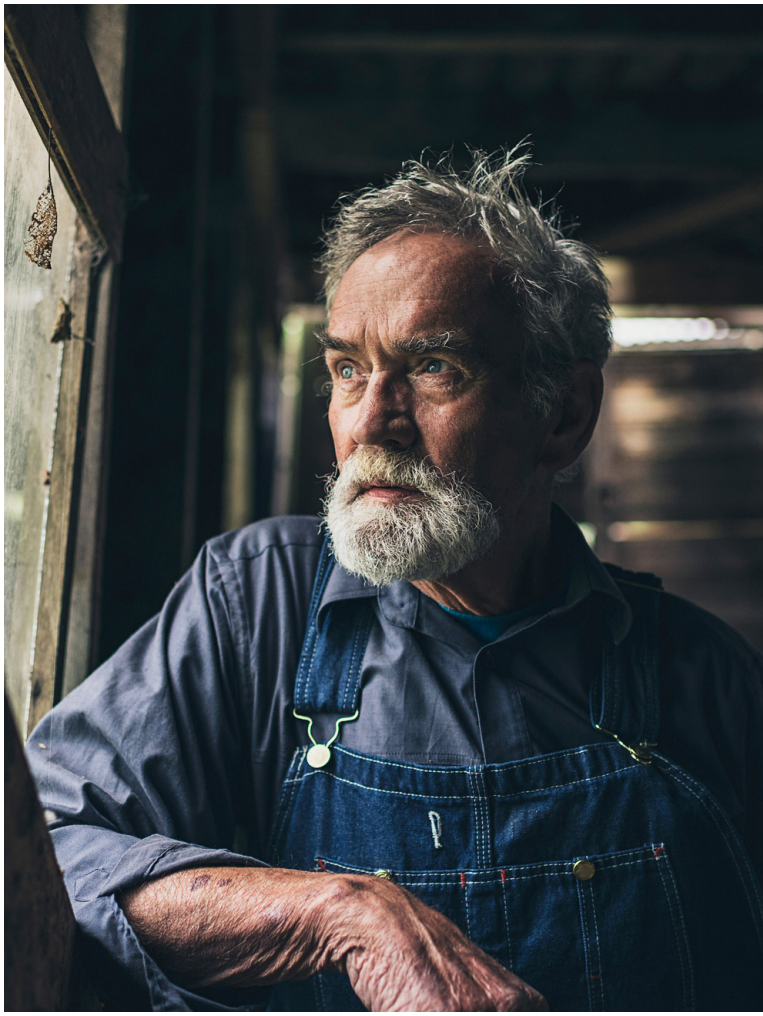
► **Did the deceased own the land but tenant it out? If so, when was the tenancy agreement entered into and what are its terms**? Subject to the answers to these questions APR might be at 100%, 50% or possibly even 0%. In this case, the deceased should have owned the land for seven years, which was occupied by the tenant farmer, who used it for agricultural purposes throughout that time.

Once one has established that there is land which may have been used for agricultural purposes, **it is then also necessary to look at the assets situated on it, such as outbuildings, farm cottages and the farmhouse, to see if they would attract APR**. This in itself throws up many questions such as:

► **Outbuildings – What agricultural purpose do they serve**? If a building is derelict, it is unlikely it will attract APR.

► **Farm cottages – Who is occupying them**? Is it a present or retired farm employee and, if so, under what terms? If it was simply used for holiday letting then APR would not be available.

► **Farmhouse – Is it the centre of operations for the farming activity**? If the landowner occupies the farmhouse and then he lets out the land, then APR would possibly not be due as regards the farmhouse.



► **Farmhouse - Does the character and size of the property suit the surrounding land**? A house with surrounding barns, sat in the middle of 500 acres of farming land, which has been used as a farmhouse for 200 years, is likely to qualify. A mansion set amongst manicured lawns and just 20 acres of grazing land, possibly won't qualify.

It is very important to note that APR is only available on the agricultural value of the land or property, which in many cases (but not all), will be less than the actual market value. So, for example, you could have land with an agricultural value of £9,000 per acre, but if it is ripe for development, the development value might be £100,000 per acre. APR could only apply to the £9,000 and not the £100,000.

TIP...

Where APR cannot be obtained in full or in part, another IHT relief, called Business Property Relief, may be available to be claimed and, in the case of the farmhouse, possibly the Residence Nil Rate Band relief. If you are concerned about your IHT position please do not hesitate to contact us for a comprehensive review.

Quick Fire Inheritance Tax (IHT) Tips

The 7-year rule – Normally, if a person dies within 7 years of making a gift, the market value at the time it was made comes back into the deceased's Estate for IHT purposes on death. The IHT Nil Rate Band (NRB) relief of £325,000 is set first against the value of those gifts. The excess value above the NRB is potentially liable to IHT at 40%. However, if the gift was made between years 4 and 7 inclusive, prior to death, the IHT rate could fall to as low as 8%. It is important to keep records of when gifts were made and the amounts involved.

The following will be immediately outside your Estate for IHT purposes:

Annual gift exemption (AGE) – Each person can make annual gifts totalling £3,000 per tax year. If you have not used up you AGE from the previous tax year you can carry over the excess to the following tax year.

Small gifts exemption (SGE) – You can give up to £250 to as many people as you like, per tax year, as long as you have not claimed another IHT allowance (for example AGE) in respect of a gift made to that same person.

On marriage or civil partnership - you can give up to £5,000 to a child, £2,500 to a grandchild or great-grandchild or £1,000 to any other person. This can be given on top of the AGE, but not the SGE, to the same person. For example, to your daughter, who is getting married, you could give up to £8,000.

Regular gifts out of income – As long as the gifts are regular and they do not affect your lifestyle, plus they come out of income and not from capital, then they will be immediately outside your estate for IHT purposes. It would be wise to formalise that arrangement.

TIP... **If you have drawn up a Will regularly review it to make sure that it complies with the present tax legislation and your wishes. This is especially relevant if circumstances change such as marriage, divorce, birth of a child/grandchild, an inheritance or health issues. Please do not hesitate to contact us if you need help in this regard.**

We are here to help

We can help you by ensuring that you're aware of the changes that will affect you, your family and your business. To find out more about the ways that we can help you, do not hesitate to contact us.

businessVision
Unit 4, Sandy Court, Ashleigh Way,
Plympton, Plymouth PL7 5JX

Tel: 01752 752210
Email: support@marclawson.co.uk
www.bvisionaccountants.co.uk