The Taxing Wealth Report 2024

Every politician's guide to "How to pay for it"[1]

Inheritance tax reforms

Reforming business property relief

Brief summary

This note suggests that:

- Inheritance tax business property relief currently costs £3.2 billion a year.
- The relief is open to abuse, which opportunity is well known and is advertised. Where that abuse is possible the relief should now be withdrawn.
- There is limited evidence of an economic need for this relief in other cases, although the provision of deferred payment arrangements to prevent business disruption at the time of the death of the owner of business assets is entirely appropriate.
- Payment deferral periods of up to three years might be permitted in those cases where 50% inheritance tax business property relief is provided at present.
- Payment deferral periods of up to five years might be permitted in those cases where 100% inheritance tax business property relief is provided at present, with the option for extension at the discretion of HM Revenue & Customs.
- Up to £3.2 billion of additional tax might be collected per annum over time as a result of the adoption of these recommendations.

[1] This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See https://www.financeforthefuture.com/taxing-wealth/. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP.

The proposal	To abolish inheritance tax business property relief in cases where it is likely to be abused and to replace it in other cases with generous deferred payment periods so that the disruption that might result from making forced sales soon after death to settle inheritance tax liabilities is avoided, thereby protecting the ongoing business subject to this arrangement.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by this exemption which removes an inheritance tax charge at the time when a capital gains tax is also avoided in many cases. 2. To increase the prospect of vertical equity of taxation in the UK which is currently undermined by this relief. 3. To reduce the tax spillover effect that this exemption creates by encouraging the ownership of business property at death. 4. To reduce the rate of tax avoidance in the UK which this exemption encourages. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation is likely to be small. The reasons for providing this relief are respected by the proposal made, which grant significant time to make payment of the inheritance tax payable on most business assets, so avoiding any serious business interruption that may result from the requirement to do so. At the same time the opportunity to abuse this relief is closed.

	There are unlikely to be few realistic objections to this proposal. Based on reasonable assumptions this relief might cost more than £3.2 billion annum at present and this sum is likely to be raised in future as a result of its cancellation.
Ease of implementation	Relatively straightforward.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Moderate because objections are likely to be made and will have to be heard.

Background

Inheritance tax business property relief is a widely used exemption within the UK inheritance tax regime.

HM Revenue and Customs have the following to say about this relief[2]:

> *You can get 100% Business Relief on:*
>
> - *a business or interest in a business*
> - *shares in an unlisted company*
>
> *You can get 50% Business Relief on:*
>
> - *shares controlling more than 50% of the voting rights in a listed company*
> - *land, buildings or machinery owned by the deceased and used in a business they were a partner in or controlled*
> - *land, buildings or machinery used in the business and held in a trust that it has the right to benefit from*
>
> *You can only get relief if the deceased owned the business or asset for at least 2 years before they died.*

[2] https://www.gov.uk/business-relief-inheritance-tax/what-qualifies-for-business-relief

Some restrictions do apply.

Notably, and surprisingly, the ownership of shares quoted on the third tier of the London Stock Exchange (the Alternative Investment Market, or 'AIM'[3]) qualifies for 100% inheritance tax business property relief on death if the shares in question had been held for two years at that date. This is the case even if there is no other connection with the entity in which the shares are held, meaning that a portfolio of shares can be held to achieve the goal of reducing inheritance tax.

As one tax adviser put it on their website in 2022[4] when talking about investing in AIM shares for this reason:

> *If you need your money to receive an inheritance tax exemption quickly, these can be a great option. Significant lifetime gifts, whether made directly to a beneficiary or to a trust, typically take seven years to fall completely out of your estate, so it can become a bit of a gamble in later life. This is why investments that attract business relief are more commonly deployed for older clients who have greater clarity as to the level of assets they'll need to provide their income until death. There are few other options that provide full relief in as little as two years.*

It is not known how widely commonly structures of this sort are used but given that relief for share investments is the most common claim made it is quite possible that this arrangement is quite widely used. It is certainly well known. It is very obviously abusive of the principles inherent in the legislation.

The amount of inheritance tax business property relief claimed

In the tax year 2020/21, which is the one for which most recent data is available[5], inheritance tax business property relief was claimed by 3,380 estates. The total relief sum claimed amounted to £3,200 million, or approximately £946,745 for each claim made.

Of the claims made, 2,350 were for shares in qualifying businesses. These claims had a total value of £2,550 million, or an average of £1,085,106 each.

[3] https://www.investopedia.com/terms/a/alternative-investment-market.asp
[4] https://www.saltus.co.uk/the-financial-planning-blog/business-relief-and-aim-an-option-for-reducing-inheritance-tax#:~:text=Investing%20in%20AIM%20shares%20can,tax%20relief%20within%20two%20years.
[5] https://www.gov.uk/government/statistics/inheritance-tax-statistics-table-122-exemptions-and-reliefs

The remaining 1,210 claims were for other business assets, with a value of those reliefs totalling £642 million (the figures do not quite total in the original data). These claims had an average value of £530,578.

The logic behind inheritance tax business property relief

The logic implicit in this relief is that it is important that a business survive the death of its owner or owners without business disruption arising from the need to realise capital to make payment of inheritance tax. As a consequence, interests in the most illiquid of businesses are provided with 100 pe cent tax relief, whilst those with greater liquidity are offered a lower, 50 per cent, rate of relief.

There are a number of very obvious problems with the supply of this relief on a universal basis without taking into consideration the particular circumstances of the business under review. These include:

- That in many cases there may be no significant disruption resulting from the death of the owner of a person owning assets qualifying for inheritance tax business property relief, or in raising capital to make settlement of any resulting inheritance tax liabilities. This might be most particularly true in the case of minority shareholdings. It will almost invariably be true in the case of AIM shareholdings held for the purpose of tax avoidance. This relief encourages abuse.

- That the preservation of capital amongst the heirs of those who created a business interest is not necessarily in the interests of the business itself. There are many examples where the second generation of owners of a business add no value (at best), whilst third generations frequently destroy it. The logic within this relief that the preservation of capital in a tight ownership group is beneficial has no obvious evidential support in the modern economy.

- That it is inappropriate that the owners of assets of this sort should have the opportunity to avoid inheritance tax in addition to avoiding capital gains tax on gains they might have made during their lifetime on the property in question, which charge is cancelled on death. This double taxation relief makes this relief particularly generous as well as open to abuse.

These situations all suggest that:

- The relief might be too generous.

- The relief is open to abuse.

- The assumptions underpinning the relief are inappropriate.

- An alternative is needed.

Recommendation

A number of recommendations flow from these observations and those in the background section:

1. No relief should be provided on assets only held for investment purposes in businesses qualifying for this relief. The opportunity to obtain inheritance tax relief by buying a portfolio of AIM shares should be prevented altogether in the future.

2. Relief for the assets now subject to 50% business property relief is inappropriate. Alternative funding for these assets should always be available given suitable time to make appropriate arrangements. The possibility of making an application for the deferment of payment of inheritance tax owing for a period of up to three years should be made available in such cases, whereafter it should be payable in full. Deferment should be allowed on a case-by-case basis. This would permit time for necessary arrangements to be made without disruption to the business resulting.

3. The inheritance tax due on the disposal of assets now subject to 100% inheritance tax business property relief should be deferred for a period of no more than 5 years, with extensions being permitted on a case-by-case basis. Capital gains rebasing at the time of rebasing should be permitted, but a charge should be placed over assets so that they cannot be sold without the liability to inheritance tax due being paid. Revaluation of liabilities owing to take into account changed market circumstances should only be permitted in the first two years following death.

These proposals withdraw inheritance tax business property relief altogether in cases where it is currently likely to be abused and turn it into a deferred payment arrangement in other cases to prevent the disruption that might occur by demanding payment soon after the time of death of the owner of a business or asset. The reasons for originally providing this relief are respected. The opportunity to save two taxes (i.e. both capital gains tax and inheritance tax) is, however, denied, creating much stronger vertical and horizontal tax equity as a result whilst raising £3.2 billion in additional tax revenue over time on an annual recurring basis.