Law Society of Scotland

Consultation Response

Reforms to inheritance tax reliefs: consultation on property settled into trust

April 2025

Photo: East Lothian

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Introduction

The Law Society of Scotland is the professional body for over 13,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Tax Law and Trust and Succession Law sub-committees welcome the opportunity to consider and respond to the HM Revenue and Customs consultation: *Reforms to inheritance tax reliefs: consultation on property settled into trust*.[1] The sub-committees have the following comments to put forward for consideration.

General Comments

The proposed Inheritance Tax (IHT) reforms to Agricultural Property Relief (APR) and Business Property Relief (BPR) will have a number of impacts in relation to trusts. These reforms do create a number of complexities and possible unintended consequences. Amongst the anticipated impacts, it is envisioned that many of these proposals will increase the administrative costs for trusts significantly. We have commented on the impact of the proposed reforms in further detail below.

The impacts of these proposals in relation to trusts are, so far, the only aspect of the inheritance tax changes that have been put out for consultation. We would stress the need for further consultation on the wider proposals in general at the earliest possible stage. Alongside this, we would express concern about the timeline for draft legislation to be introduced. This is due to the potential for unforeseen consequences and the number of practical complexities that could arise from these reforms. This comment is deliberately wider than the specific subjects of this consultation; and some of our comments below go somewhat beyond trusts, as does the first question (and our response) in the consultation itself.

[1] Reforms to inheritance tax reliefs: consultation on property settled into trust - GOV.UK

Consultation Questions

Question 1: Are the rules on the application of £1 million allowance for individuals sufficiently clear for transfers made on or after 6 April 2026? What are your views on this?

It is welcome that the £1 million allowance renews every 7 years.

It is assumed that the £1 million allowance will not be affected at all by exempt transfers; and on that assumption changes will be required to the way that the reliefs are given, essentially reducing only chargeable transfers rather than transfers of value.

If this assumption is incorrect, then further clarity would be required in more complex cases relating to transfers. The below example lays out one such scenario.

A farm belonging to a deceased farmer has diversified by turning a building adjacent to the farmhouse into a Bed & Breakfast (B&B). The B&B is largely run by the farmer's spouse and on his death it is his intention that he leaves the B&B to his spouse and the remainder of the farm to his son, who will take over the farming operation. If a proportionate allocation of the relief between the farm and the B&B is compulsory, part of the £1 million allowance will be allocated to the B&B. The consultation seems to state that spousal exemption will apply *after* the value of any available reliefs have been deducted, which would mean that the farmer will be unable to utilise his £1 million allowance because part of it will be compulsorily allocated to the B&B passing to his spouse.

We think, including from the terms of the original Budget announcement of these changes, that this is not the policy intention of these changes; and if that is the case then amendments to the structure are anticipated, as currently reliefs reduce the transfer of value and not the chargeable transfer.

Clarity would also be welcomed as to how the £1 million allowance will interact with the operation of section 39A of Inheritance Tax Act 1984 (IHTA). This is of particular concern in Scotland, where a claim to legal rights falls to be treated as a specific gift of property regardless of the deceased's intention. This again is a structural question on the manner in which the reliefs will be applied.

Whilst Business Relief and Agricultural Relief are legally automatically applied, in practise Executors are required to ensure the correct paperwork is filled in to receive this. Given this practicality, on what basis will the allocation of the allowance between different types of asset be applied if the Executors choose not to claim relief in respect of some assets?

In the above scenario, the farmer plans to avoid the loss of part of his £1 million allowance by transferring the B&B to his spouse during his lifetime. He dies within 7 years of making the transfer. If the £1 million allowance is deducted before the spousal exemption is applied, does the chronological application of the allowance mean that the transfer of the B&B exhausts the £1 million allowance leaving none to be allocated to the farm? If that is the case, a failed PET leaves the taxpayer in a significantly worse position than he would have been had he carried out no planning at all, as contrasted with the current position where the failure of a PET leaves the taxpayer with the same Inheritance Tax liability as he would have suffered had he not made the PET. This introduces an element of what might be described as "gambling" to Inheritance Tax planning. Given the likelihood of death occurring within 7 years is significantly increased for those of advanced years and those with disabling illnesses it is concerning that these groups may be left in the position where planning to mitigate their tax liability (as advised by the Government) in fact puts them in a worse position than their younger, able-bodied counterparts.

Clarity is also required on the interaction, if any, between relevant assets held directly and those held in pensions funds when the latter are brought into chargeability.

Continuing the above scenario, the farmer's SIPP holds a number of fields, all of which are qualifying agricultural property. How does the proposal to bring unused pension funds into the Inheritance Tax calculation on the scheme member's death affect the allocation of the £1 million allowance, if at all? Executors and Scheme administrators will not be able to ascertain how much of the £1 million exemption they have available (and therefore how much tax is payable) until HMRC have confirmed whether or not they have accepted all claims in full or in part. This will add significant delay and an additional administrative burden for all parties, including HMRC.

Where qualifying agricultural and business property is held in a multi-member SIPP, will it be necessary to ascertain how much of the SIPP's qualifying Business and Agricultural Property is attributable to the taxpayer before the apportionments of the £1 million allowance (a) between the estate and the SIPP and (b) between the different business and agricultural property across the estate and the SIPP can be calculated?

Further to the proposals affecting SIPPs, what is the intended interaction between an individual's pension fund and their individual allowance? Specifically, are assets held in an individual's pension fund affected by (or themselves affect) an individual's allowance?

In the context of transfers into trusts which represent chargeable lifetime transfers, we have serious concerns about the practicality of applying the £1 million allowance chronologically. Currently, provided the taxpayer is confident that relief is applicable (on which he is able to seek advance clearance) there is no requirement for him to seek a professional valuation of the assets being transferred. In respect of some categories of assets, our members have already reported difficulty in securing the services of a suitably qualified valuer. Even where a professional valuation is available, given the imprecise nature of valuation, HMRC's agreement on the value of the assets transferred will be necessary for every transfer of qualifying business or agricultural property in order that the taxpayer knows either how much of his £1 million allowance remains or how much Inheritance Tax is due on the transfer. Unless there is a mechanism for the taxpayer to obtain HMRC's agreement on the value of the property before he transfers it to the trust he is left in the position that he cannot know whether or not he has incurred a tax liability until HMRC reviews the IHT100 return which he submits. The lack of certainty this creates is unfair. Even if advance agreement on valuation is possible, in volatile business environments, unless HMRC respond to the request extremely quickly, the valuation may not still be accurate by the time the transfer to trust actually takes place. Given ongoing difficulties with HMRC's resourcing we are concerned about the capacity to issue these agreements within the timeframe demanded by a constantly moving business marketplace.

Question 2: Are the rules on the application of the £1 million allowance for 10-year anniversary charges and exit charges sufficiently clear for property settled on or after 6 April 2026? What are your views on this?

The proposed rules are relatively clear and largely mirror the current application of the available nil rate band. However, clarification over the date at which the £1 million allowance will refresh would be welcome.

Will the refresh be tied to the date of the Principal Charge or some other date? Where section 80 or section 81 IHTA are in consideration the date of the Principal Charge may not be immediately obvious and there may be different commencement dates for different funds within the same trust. This application risks adding further complexities and administrative costs for the majority of trusts in an already complex area of practice.

Furthermore, the proposed rules do not provide sufficient clarity on the distinction between the two differing effects of the proposals on the trust property subject to the tax itself and the use of the allowance/relief calculation of the new rate of tax. Clarity on this point would be welcomed.

Question 3: What are your views on the proposal to standardise the calculation of Inheritance Tax exit charges, so that all exit charges are calculated based on unrelieved values regardless of whether the exit takes place before or after the first 10-year anniversary?

The standardisation proposals have been structured in favour of increasing the tax burden. It is accepted and appreciated that the intention behind this proposal is to bring consistency to exit charge calculations regardless of which ten year anniversary they precede. However, the rules as currently applied have the benefit of logic and consistency in the context of the wider calculation. Exits within the first ten years are calculated by reference to the trust's value at the date of commencement and Agricultural Property and Business Relief are theoretically applicable. However, at the date of commencement, the two (or 7) year holding criterion is not met by the Trustees and therefore while the relief is applicable in the calculation, the Trustees will not qualify for it.

To maintain consistency, an appropriate action would be to preserve this existing logic if, instead of arbitrarily removing relief for subsequent anniversaries, the legislation instead allowed Trustees to "roll over" the Settlor's holding period in a manner similar to the operation of sections 108(b) and 120(b).

Furthermore, it would be possible to achieve a fairer consistency by making the reliefs available in calculating the rate whether before or after the first ten year charge. This would address the anomaly where the rate within the first ten years fails to take account the reliefs because that rate depends (partly) on the unrelieved value immediately after commencement of the settlement – when the trustees are unable to meet the ownership requirement.

Question 4: What are your views on the proposed transitional provisions for qualifying agricultural and business property settled into a relevant property trust before 30 October 2024?

These provisions are welcome, as they provide clarity and space for trusts affected by these proposals to plan ahead.

However there is a risk that the provisions are potentially arbitrary and risk creating an unfair environment for certain trusts, i.e. where a trust has a 10 year anniversary shortly after 6 April 2026.

Question 5: What are your views on the proposed transitional provisions for qualifying agricultural and business property settled into a relevant property trust during the transitional period?

Clarity is needed regarding the assumed continuing availability of taper relief for qualifying properties affected by these provisions, as there is a reference within the document to a 40% charge on a death within 7 years of a transfer into a trust.

Question 6: What are your views on introducing a single £1 million allowance for 10-year anniversary charges and exit charges where a settlor has transferred property into multiple trusts on or after 30 October 2024?

Clarification on the application of these proposals would be welcome. Per the consultation document, it is proposed that a trust's allocation of the £1 million allowance is fixed at the outset and that "If a trust can no longer use its allocation of the allowance…then the unused allowance cannot be used by related trusts by the same settlor." In this context does "related trusts" mean only trusts which are established on the same day (technical "related settlements") or does this mean any trusts established by the same settlor? Where a trust to which part of the £1 million allowance has been allocated is wound up it is clear that the consultation considers that its allocation does not transfer to the other trusts but does this also apply to new trusts created after the winding up? Clarity on these points would be welcome.

The chronological application of the allowance per the consultation gives the example of a trust being created with £1 million of qualifying business property so that none of the £1 million allowance is available to a second trust. How is it anticipated that this will be applied where the first trust is created with less than £1 million of qualifying business property? Will the amount of the £1 million allowance be permanently restricted to the value of the business property at the date it is settled or will the balance of the £1 million be available to the trust at the date of the 10^{th} anniversary provided no further trusts (or transfers to trust) have been created in the intervening period? If a second trust is created more than 7 years after the first settlement but before its 10^{th} anniversary, will the balance of the £1 million allowance be calculated by reference to the value of the property settled in the first trust as at the date of its settlement or as at the date of the second trust's creation? If the assets in the first trust were valued at less than £1 million at the point of creation but more than £1 million at the 10^{th} anniversary, will a subsequent trust settled in year 11 have access to the balance which was left at the creation of the first trust or will that value have been automatically allocated to the first trust at the 10^{th} anniversary?

It is not clear how it is intended to treat trusts created without any qualifying business or agricultural property but which subsequently acquire such assets other than by way of settlement. It seems manifestly unfair that a trust which was not originally seeded with qualifying property cannot at any point benefit from the £1 million allowance even where it is not utilised elsewhere but we have difficulty envisaging a practical mechanism which would allow unused allowance to be applied after settlement since the Trustees may not have any way to know how much of the allowance has similarly been claimed by other trusts created by the same settlor.

Furthermore, there is the fundamental question of whether the £1 million allowance within the trust renews for later settlements by the same settlor, or is the £1 million available to a settlor over all trusts created by that settlor a lifetime limit for all such trusts?

A further question arises if more than one settlor puts APR/BPR property into the same trust - presumably that trust gets the benefit of all of the settlors' available allowances, whatever the size of those available allowances.

Question 7: What are your views on introducing rules similar to the existing 'related' property provisions for Inheritance Tax, so that multiple holdings by the same settlor across multiple trusts can be connected for valuation purposes?

While we understand the motivation behind this proposal, we have concerns about its practical application. Trusts are independent entities with separate legal personalities and discrete tax obligations and we do not see what legal basis there might be for the Trustees of Trust 1 to require the Trustees of Trust 2 to provide information about the assets held within Trust 2 simply because the trusts share a Settlor.

The separate trusts may have been created at entirely different times.

To take an example – in Year 1, a settlor transfers a 15% holding from his total holding of 50% of shares in a company. Ten years later, the same settlor transfers a further 15% to a different trust. The proposal seems to be that for all possible charges (principal and exit) each of the two trusts is to be treated as holding one half of a 30% holding. But this presumably only applies after the second trust is established. The trustees of the second trust may not even know that the first trust has been created by the same settlor. The practical difficulties grow if further trusts are created with shares in the same company on death, after some lifetime transfers into trust.

Where a Settlor has created multiple trusts, introducing related property provisions will mean that each trust's assets may have to be formally valued on multiple occasions throughout a ten year cycle. Even excluding occasions of charge created by exits, a trust whose settlor has created 5 trusts will potentially have to obtain 5 separate valuations of its assets over a ten year period. Where the assets in question are shares in a limited company this may not be overly burdensome (although the difficulties of valuing different sizes of shareholding in a trading company should not be underestimated: but in situations involving mixed assets or multiple businesses the administrative burden seems to us to be excessive as compared to the mischief which the proposal is attempting to address.

Having multiple triggers for valuation will exacerbate even further the valuation issues identified in our response to Q1 regarding the availability of professional valuers and HMRC's capacity to agree valuations in advance.

The existing related property rules only apply to married couples, which is a simpler proposition.

Question 8: What are your views on the application of the £1 million allowance to special trusts, age 18 to 25 trusts and QIIP trusts?

The proposed position seems reasonable for 18-25 trusts.

The proposal for QIIP trusts risks creating an unfair situation. The proposal here seems to be that there should be no separate allowance for such trusts – the aggregation principal is to be applied without relief. The person with the QIIP may have had very little benefit from the QIIP, and yet can find their personal allowance eroded considerably by their interest in the QIIP. Consideration should be given towards the creation of a separate allowance for QIIP trusts. This would avoid any risk of unfairness and align with the proposed treatment of relevant property trusts.

Question 9: Do you have any further views on the application of the £1 million allowance to property which has been settled into trust?

While the following points do not relate directly to trusts, they apply to trusts as much as to any other taxpayers affected by the proposals.

We note that the government's policy intention in introducing the £1 million allowance (in respect of assets settled into trust or in respect of an individual's estate) is to prevent assets of very significant value being passed to subsequent generations without being subject to Inheritance Tax. However, there may be significant practical difficulties in businesses raising the liquid cash required to meet an Inheritance Tax liability. If the business attempts to build up cash reserves to allow a liability to be met, it risks those cash reserves being treated as excluded property in the assessment of the relief available.

Even where sufficient cash reserves exist within the business, the tax liability does not fall on the business itself but on the Executors of the deceased's estate or the Trustees of a Trust. This means that, in order to settle the Inheritance Tax liability the Executors or Trustees will be required to extract the cash, creating an income tax, capital gains tax or corporation tax liability. In these circumstances the combined practical effect of the different tax regimes will give an effective rate of tax far in excess of the 20% which the government has indicated. The interaction of the inheritance tax position with other taxes which may become relevant may require further consideration.

For further information, please contact:

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