8.4 Relief for IHT

8.4.1 Introduction

Where there has been a transfer for IHT purposes, and the asset being transferred is a chargeable asset for CGT purposes without any reliefs, any gain above the annual exemption will be charged to CGT at the transferor's appropriate rate at the time of the gift. In addition, there could also be an IHT charge.

If the IHT transfer is a PET, there are no IHT consequences in lifetime, and as long as the donor lives for seven years following the gift there will be no additional charges to IHT. If the donor does not live for at least seven years, however, there may be an IHT charge later (subject to the deceased's nil-rate band) at the time of the death of the donor.

Likewise, if the IHT transfer is a chargeable transfer, IHT will be chargeable immediately at the time of the transfer.

The CGT legislation allows some relief for this IHT charge by reducing the gain on the subsequent disposal of the asset in question.

8.4.2 Section 165 opportunities for IHT relief – PETs and chargeable transfers

As discussed above, relief for CGT is available through gift or holdover relief where the gifted asset that is the subject of the chargeable transfer is a business asset under s. 165. This is available whether the transfer is a chargeable lifetime transfer or a potentially exempt transfer, as in the case of business assets both may be held over.

IHT relief is available on the subsequent disposal of the asset by the donee, if it had originally been subject to such a holdover relief claim. Any IHT due to be paid on the receipt of the asset becomes another cost of the asset included with the historical cost, any enhancement expenditure and incidental expenses.

For example, if a transferee received an asset by either a gift or a bargain not made at arm's length, and the base cost of the asset was reduced as a result of gift relief, if the transferee is subject to IHT on that asset due to the transferor not surviving for seven years, the IHT can be a deductible cost and reduce the gain. It could even reduce the gain down to zero; but the deduction cannot create a loss.

Example

In 2012, Martha gave her son a furnished holiday let business which qualified for gift relief for business assets under s. 165. The gain on the property was £30,000 which both she and her son agreed would be held over to him, and the appropriate claim was made.

Martha died in 2017.

Unfortunately, as she had exhausted all of her nil-rate band, there was an inheritance tax charge on her son at her death, as a result of the failed PET, of £7,000. Business property relief was not available.

Her son sold the property at a £50,000 gain in 2023. The CGT chargeable on her son in 2023 is calculate as:

	£
Gain	50,000
Inheritance tax paid on the property, subject to s. 165 holdover relief (due on the failed PET)	(7,000)
Chargeable gain	43,000

No claim needs to be made for the IHT relief which is automatic.

The ability to deduct any potential future IHT from the eventual gain made by the transferee (as seen in the example above) is only possible if a gift relief claim under s. 165 had been made. There is an argument, therefore, that a gift relief claim should always be made on the disposition of business property even if there is no gain arising at the time of the original disposal. This practice ensures that the potential for a reduction in any future gain by any possible IHT payable is retained by the transferee in the case of an unexpected death of the transferor within seven years.

8.4.3 Section 260 opportunities for IHT relief – PETs

Usually, there is no opportunity to obtain inheritance relief if the transfer was a PET.

There is, however, a type of mitigation which comes in the form of the initial transfer value. For IHT purposes, the value of the transfer is calculated using the loss-to-donor principle (see **9.3.2**).

For example, say the gift was valued under the loss-to-donor principle at £400,000 and there was CGT to pay of £50,000. It would not be

unreasonable to expect that the real loss to the donor was the gift *and* the CGT, as the CGT needed to be paid in order to make the transfer. If the loss to donor included the CGT paid, this would make the total gift £450,000 and, as such, the eventual IHT – either immediately on a chargeable transfer or later (on a death within seven years of the donor) – would be higher. However, the CGT payable on the asset being transferred (or any other taxes charged as a result of the gift) is not included in valuing the transfer for IHT purposes and, as such, does not raise the value of the transfer.

Sometimes under the CGT legislation, the donee will need to pay the CGT even where there has not been a holdover claim. If an asset has been gifted, and the donor has not paid the CGT within 12 months from the date payable, HMRC can turn to the donee for the tax. If this situation occurs, any IHT paid on a failed PET can reduce the eventual gain on a subsequent sale (in the same way as the Martha example above for s. 165).

8.4.4 Section 260 opportunities for IHT relief – chargeable transfers

A gift subject to IHT, which is also subject to CGT, may have the CGT liability held over into the cost of the asset in accordance with s. 260. In these cases, IHT relief is available on the subsequent disposal of the asset by the transferee similar to that described above in s. 165. This is an automatic relief so it doesn't require a claim, and it doesn't matter which party actually paid the IHT originally.

Example

In 2013, Monica settled a chargeable asset worth £400,000 into a trust which qualified for gift relief under s. 260. The inheritance tax arising on the transfer was £50,000, and paid by Monica. The chargeable gain arising on the asset was held over to the trustees, and the appropriate claim was made.

The trustees sold the asset in 2023 making a gain of £100,000. The CGT on the trustees in 2023 would be:

	£
Gain	100,000
Inheritance tax paid on shares subject to s. 260 holdover relief (on entry into the trust)	(50,000)
Chargeable gain for the trustees	50,000

Law: TMA 1970, s. 43; IHTA 1984, s. 3, 5, 24, 27-30, 57, 164-165; TCGA 1992, s. 165, 260

Guidance: CG 67033, 67034

8.5 Pitfalls and planning points

Avoiding lifetime sales for certain assets

If an asset is standing at a gain in lifetime, and it is eligible for a relief at death (such as business or agricultural relief), it will usually be better to retain it so that it is in the death estate, rather than to dispose of it before death and thereby incurring a CGT liability. Assets eligible for death estate reliefs such as these will obtain the free CGT uplift on death, and will also not be subject to IHT due to the relief. They can then be sold by family members with the base cost being the probate value, i.e. the value at the date of death, so that no gain (or very little, depending on how soon after probate the asset is sold and how quickly the asset is rising in value) is realised by the disposing parties.

Assets with potential CGT losses

If an asset is in a loss-making position, and further depreciating, it may be prudent to retain it too in the estate at death. If it was instead gifted prior to death, the value at the time of the PET or CLT would be the value charged to IHT if the death was inside seven years. The value in the death estate (for some assets in the absence of *post mortem* value reliefs) will therefore be lower for a depreciating asset.

In addition, if gifted before death, the individual is unlikely to be able to use the CGT loss against other gains as gifts are usually made to connected parties for whom losses are ring-fenced.

Fall-in-value relief

For some assets that have fallen in value since the gift, there is fall-in-value relief (see **Chapter 6**). This can reduce the IHT due on a failed PET or additional tax due at death on a CLT. However, this does not transfer

through to the cumulative "clock" total in the death estate, so will not mean that there is more nil-rate band available at the death.

Avoiding lifetime transfers of assets with capital gains

A very disadvantageous situation, to try to avoid, is the lifetime gift of an asset standing at a gain, where the donor is unlikely to live for a further seven years, and where holdover relief is not available. In this situation, CGT would be payable on the transfer, but IHT will also eventually be payable at the death (albeit possibly at a reduced rate due to taper relief the closer the deceased is to having lived for seven years). In this situation, it is not possible, under s. 260, to hold over the CGT to the transferee retrospectively.

Insuring against IHT liabilities

In situations such as the point immediately above, or other situations where a gift has been made and CGT has been charged and paid in life, it may be possible to mitigate, by insurance, the potential IHT charge at 40% should the donor not live for seven years. Cover such as "diminishing term assurance" may be an option. This can be taken out on the life of the donor by the donee in order to cover any IHT liability that may become due.

Gift relief claims for business property even where no gain arises

As it is only possible to obtain IHT relief from any eventual gain made by the transferee (as seen in the Martha example above) if a gift relief claim had been made, it is always sensible to make such a gift relief claim on the disposition of business property under s. 165, even if no gain arises at the time of the original disposal. This ensures that the potential for a reduction in any future gain (by the IHT payable) is retained by the donee if the donor dies unexpectedly within seven years.