



House of Commons
Committee of Public Accounts

Inheritance Tax

Twenty-ninth Report of Session 2004–05

*Report, together with formal minutes,
oral and written evidence*

*Ordered by The House of Commons
to be printed 6 April 2005*

The Committee of Public Accounts

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Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Nick Wright (Clerk), Christine Randall (Committee Assistant), Ronnie Jefferson (Secretary), and Luke Robinson (Media Officer).

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Contents

Report	<i>Page</i>
Summary	3
Conclusions and recommendations	5
1 Securing the right amount of tax on time	7
Compliance investigations and the 'tax gap'	8
Artificial avoidance	9
Penalties, prosecutions and directions	9
Caseload management	11
2 Making the tax procedures easier for representatives	13
The ease-of-use of the tax returns	13
Guidance for representatives	13
Payment terms	14
3 The heritage exemption	15
Formal minutes	16
Witnesses	17
List of written evidence	17
List of Reports from the Committee of Public Accounts Session 2004–05	18

Summary

The estate of a person who has died may be liable to Inheritance Tax. Bequests to spouses and charities are exempt, as are some heritage, agricultural and business assets. The tax is charged at 40% of the value of other assets, above a nil-rate band (£263,000 in 2004–05). The value of estates has risen in recent years, particularly house values which have outpaced increases in the level of the nil-rate band. The number of estates liable to the tax has therefore grown, to 30,000 in 2003–04. The Revenue collected £2.5 billion in Inheritance Tax that year, around 1% of the Revenue's net tax receipts.

The Committee last examined Inheritance Tax in 1999,¹ and recommended improvements in the way the Inland Revenue administered the tax, including strengthening its compliance checks and imposing penalties on those not complying; speeding up the processing of long-outstanding cases; and more rigorous enforcement of the conditional tax exemption scheme for heritage assets.

Securing the right amount of tax on time

The Revenue received 67,500 Inheritance Tax returns in 2003–04, launched compliance enquiries into 3,600 cases and secured an additional tax yield of £126 million. This represented a two-thirds increase in caseload since 1998–99, though managed with a similar level of staffing. The Revenue has also settled cases more quickly and reduced the number of long outstanding cases.

Since the Committee last reported, the Revenue has made greater use of information held by different parts of its organisation to inform its compliance investigations, and improved procedures for identifying undeclared gifts and tackling other compliance risks.

The Revenue cannot give a firm estimate of how much tax is lost from non-compliance because, unlike the United States Internal Revenue Service, it has not measured the Inheritance Tax 'tax gap' – the difference between the theoretical tax payable and the actual amount collected. It has now started to deal with this, drawing on the US experience. To help tackle artificial avoidance—part of the tax gap—the Revenue has monitored such schemes and challenged them through litigation and legislation, including a recently introduced tax charge on the benefits that continue to be derived from assets given away.

The Revenue can apply penalties for negligent inaccuracies in tax returns, but used this sanction on only 100 cases in 2003–04. It has recently secured its first successful prosecution for Inheritance Tax fraud. In applying penalties, the Revenue has abated the maximum available penalty according to the gravity and nature of the offence, including whether errors were voluntarily disclosed and the extent of cooperation. The Revenue also applied significant abatements, however, even when it discovered errors or omissions.

1 38th Report from the Committee of Public Accounts, *Inheritance Tax: a progress report* (HC 474, Session 1998–99)

Making the tax procedures easier for representatives

While many people use solicitors or other professionals to deal with their Inheritance Tax affairs, 30% of tax returns are submitted by personal representatives. To help make the Inheritance Tax system easier to use, the Revenue has set up a joint probate/Inheritance Tax helpline, improved its website guidance and introduced a shorter, easier to complete, form for the majority of estates. But the main Inheritance Tax form remains difficult to use, and there is uncertainty among personal representatives about what is required in valuing property.

The heritage exemption

Assets of sufficient heritage importance can be exempt from Inheritance Tax, provided they are conserved and reasonable public access is provided. Following the Committee's 1999 report, the Revenue and heritage agencies have worked more closely in checking that exemption conditions are being met, and there has been less slippage in the programme of inspections. The Revenue has also publicised exempt assets and public access arrangements, and extended its register of heritage assets to include chattels as well as properties.

Since 1998 all new exemptions for heritage chattels require some open access for the public, without a prior appointment. The Revenue has also used its powers to renegotiate existing agreements with 16 of the 44 owners with the most significant collections, to provide open access to 1,900 chattels.

On the basis of a Report by the Comptroller and Auditor General,² we examined the Inland Revenue on securing the right amount of tax on time, making the tax procedures easier for representatives, and the operation of the heritage exemption.

Conclusions and recommendations

- 1. The Revenue has no measure of the gap between the Inheritance Tax theoretically payable and the actual amount collected**, but it now intends to draw on the experience of the US Internal Revenue Service to estimate the tax gap on undeclared or under-valued assets. It should also analyse data it collects on the composition of estates to identify cases for enquiry where there is an unusual mix of assets.
- 2. The 2004 Finance Act introduced new disclosure obligations on those marketing some avoidance schemes, but so far the regulations do not apply to Inheritance Tax schemes.** The Revenue currently monitors artificial schemes and seeks to block them through litigation or changes in legislation. The Revenue should consider extending the regulations on disclosure to Inheritance Tax avoidance schemes.
- 3. The average penalty levied after applying abatements has been only 7% of the maximum available, rising to 12% in cases where the Revenue discovered the negligence.** The 1999 Finance Act increased the maximum penalties for fraud or negligence in Inheritance Tax. The Revenue should also restrict abatements of penalties, not only to encourage representatives to disclose errors voluntarily, but also to deter them from being negligent in submitting inaccurate returns in the first place.
- 4. In recent years the Revenue has processed Inheritance Tax cases more quickly, and reduced the backlogs of long-outstanding cases, but it still has nearly 900 cases over three years old and 83 over ten years old.** The Revenue has invariably secured the co-operation of representatives once it has issued directions to obtain information, but since 1999 it has only used these powers on 82 occasions. The Revenue should set targets to reduce further the number of long-running cases, making full use of its powers to issue directions to secure the information it needs to conclude enquiries.
- 5. Given the difficult circumstances in which people have to deal with Inheritance Tax, the Revenue should make it as easy as possible for representatives to meet their obligations.** The Revenue has improved the tax returns, but the main form is still difficult for the lay representative to complete. The Revenue could simplify the language and the layout. In redesigning the forms, it consulted Inheritance Tax professionals. It should make forms easier to complete, also taking into account the views of lay representatives.
- 6. The Revenue should co-operate with other departments to develop a co-ordinated bereavement website, providing all the information and advice people need when dealing with the death of a relative.** Such a website could help people to deal with the various authorities they need to contact when someone has died. It might include an electronic service for filing Inheritance Tax and probate returns.
- 7. As well as responding to individual enquiries, the Revenue should make it easier for people to obtain guidance on Inheritance Tax from its website and leaflets.** More information might be provided on the acceptability or otherwise of the more common types of avoidance schemes, and attention could be drawn to websites that

representatives can use to value properties without the expense of professional valuations. There are also uncertainties about how properties funded by Islamic mortgages should be valued for Inheritance Tax purposes and the Revenue should consider issuing general advice on their tax treatment.

8. **The requirement to pay Inheritance Tax before probate can be obtained is an important safeguard, but it has been a problem for representatives who have had to obtain a loan to pay the tax.** The Revenue has provided a facility to pay by instalment and arrangements to access funds held in an estate's bank accounts. But it does not have information on how many estates still have insufficient liquid assets for representatives to pay the tax and secure probate. It should review the extent of the problem.
9. **The Revenue has so far renegotiated better public access with 16 of the 44 owners with the more significant collections of exempt chattels, but it could do more.** The 1998 Finance Act introduced a higher quality standard for exempting chattels and a requirement for some degree of open access for the public. Now that the Special Commissioners have upheld the principle that it could review existing agreements, the Revenue should use its powers to negotiate better public access to all significant collections of tax-exempt heritage chattels.

1 Securing the right amount of tax on time

1. The estate of a person who has died may be liable to Inheritance Tax.³ Bequests to spouses⁴ and charities are exempt, as are some heritage assets if certain preservation and public access conditions are met. Reliefs are also available for many agricultural and business assets. The tax is charged at 40% of the value of other assets, above a nil-rate band (£263,000 in 2004–05⁵). To obtain ‘probate’ and be able to administer an estate and distribute its assets, the representatives of an estate must first submit an Inheritance Tax return and pay any tax due. In 2003–04, 30,000 estates were liable for Inheritance Tax. The Revenue collected £2.5 billion during that year, around 1% of the Revenue’s net tax receipts.⁶

2. The number of estates liable to the tax has grown in recent years, reflecting the rising value of assets in estates, particularly of houses and especially of those in London (**Figure 1**). House prices have grown more quickly than the tax threshold. Around 30,000 estates were liable to Inheritance Tax in 2003–04, or one in twenty estates, compared with fewer than one in thirty in 1999.⁷ The Revenue estimates that 32,000 estates were liable for the tax in 2004–05, and that 37,000 will be in 2005–06.⁸

3 Inheritance Tax is also charged on certain gifts, and on assets held in discretionary trusts.

4 The 2005 Budget proposed measures that would enable the Revenue to confer on same-sex ‘civil partners’ the same tax treatment as spouses, from December 2005.

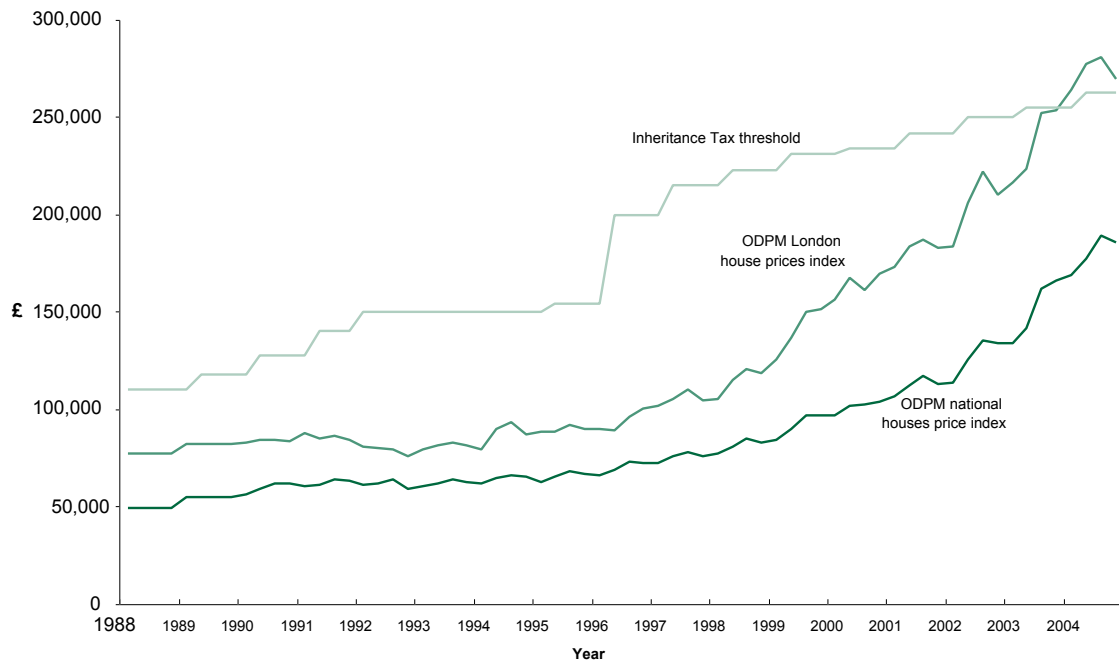
5 The 2005 Budget proposed an increase in the nil-rate threshold to £275,000 for 2005–06.

6 C&AG’s Report, Executive Summary paras 1, 11. Budget 2005, *Financial Statement and Budget Report*, Table C8

7 C&AG’s Report, *Inheritance Tax: a progress report* (HC 251, Session 1998–99), para 1.1

8 C&AG’s Report, Executive Summary para 1, para 1.1; Q 96; Inland Revenue Budget 2005 press notice PN2, 16 March 2005

Figure 1: A comparison of trends in the Inheritance Tax threshold and average house prices



Source: C&AG's Report, Fig 11; Office of the Deputy Prime Minister housing market data (Tables 505 and 506 for December 2004)

Note: Data from before 1990 is annual. Data from 1990 is quarterly.

Compliance investigations and the 'tax gap'

3. Following risk assessment and the resolution of minor queries, most tax returns require little or no further action by the Revenue. It launched detailed enquiries into some 3,600 cases in 2003–04, around 5% of the returns it received. These enquiries resulted in increases in the net taxable value of estates of £513 million, and additional tax of £126 million. The additional yield from the Revenue's enquiries increased by 32% between 1998–99 and 2003–04, but remained at around 5% of the growing tax revenue.⁹

4. The Revenue cannot give a firm estimate of how much tax is lost through the non-declaration or undervaluation of assets in estates, because it does not have a measure of the Inheritance Tax 'tax gap', the difference between the theoretical tax payable and the actual amount collected. In 2002 the United States Internal Revenue Service assessed the tax gap for its Estate Tax. By analysing a sample of cases it estimated the tax gap from under-declared or under-valued assets to be around 13% of tax receipts. In response to the C&AG's Report, the Revenue is now committed to estimating the tax gap, drawing on the US experience. It has recently started a similar exercise to examine a random sample of 100 cases.¹⁰

⁹ C&AG's Report, paras 2.2–2.4

¹⁰ *ibid*, paras 2.20, 2.23; Qq 2–3, 65

5. To strengthen its compliance work on Inheritance Tax returns, the Revenue has made greater use of information held by different parts of its organisation. This information has helped it to improve the way it has identified cases with undeclared gifts which the Committee identified as a risk area in 1999. In response to the Committee's recommendation the Revenue conducted a special exercise and refined its guidance on risk indicators. It also examines data held on the Income Tax return database and by the Complex Personal Returns section (who deal with high-income individuals) to look for changes in income that might suggest that gifts have been made. Its investigations yielded £14 million of additional tax on gifts in 2003–04 compared with £10 million in 1999. In addition, a Revenue examination of the use of offshore trusts has secured an additional £11.3 million in Inheritance Tax since April 2003, with another £7.5 million in train. The Revenue has undertaken little analysis of data it holds on the composition of estates, however, to highlight estates with unusual mixes of assets and to target them for enquiry.¹¹

Artificial avoidance

6. Part of the Inheritance Tax 'gap' arises from the use of artificial tax avoidance schemes. There are various steps people take to organise their financial affairs to reduce their Inheritance Tax liability. There is a wide spectrum ranging from straightforward measures which take advantage of the various reliefs and allowances available, to more complex artificial avoidance schemes. The Revenue does not issue general information or advice on the acceptability of tax avoidance measures but responds to individual enquiries. Where people approach the Revenue for guidance on measures that clearly fall within the law, it confirms their legitimacy. However, where people are seeking to define precisely the boundaries between legitimate tax planning and artificial avoidance schemes, the Revenue does not give a definitive view, not least because it may wish to take action in due course to tackle such artificial schemes. People cannot therefore be certain whether they have legitimately reduced the tax liability of their estate and that a marketed avoidance scheme will not give rise to a tax liability when they die.¹²

7. The Revenue monitors potentially abusive avoidance schemes in tax returns and sometimes challenges them through litigation. The Revenue has also sought changes in the tax legislation to close loopholes. For example, the 2004 Finance Act tackled 'gifts with reservation' schemes by introducing an income tax charge on the notional benefits that continued to be derived from gifted assets. The Act also introduced new disclosure rules requiring notification to the Revenue of some types of avoidance schemes when they are marketed, but so far the regulations do not apply to Inheritance Tax schemes.¹³

Penalties, prosecutions and directions

8. The Revenue has a range of sanctions at its disposal to penalise negligence and fraud and to discourage representatives from submitting inaccurate or incomplete information in Inheritance Tax returns. In 1999 the Committee recommended that the Revenue

11 C&AG's Report, Executive Summary para 6, paras 2.2, 2.8–2.9, Figure 8, Appendix 2; Qq 49, 67–68, 97

12 C&AG's Report, paras 2.17–2.18; Q 5

13 C&AG's Report, paras 2.18–2.19

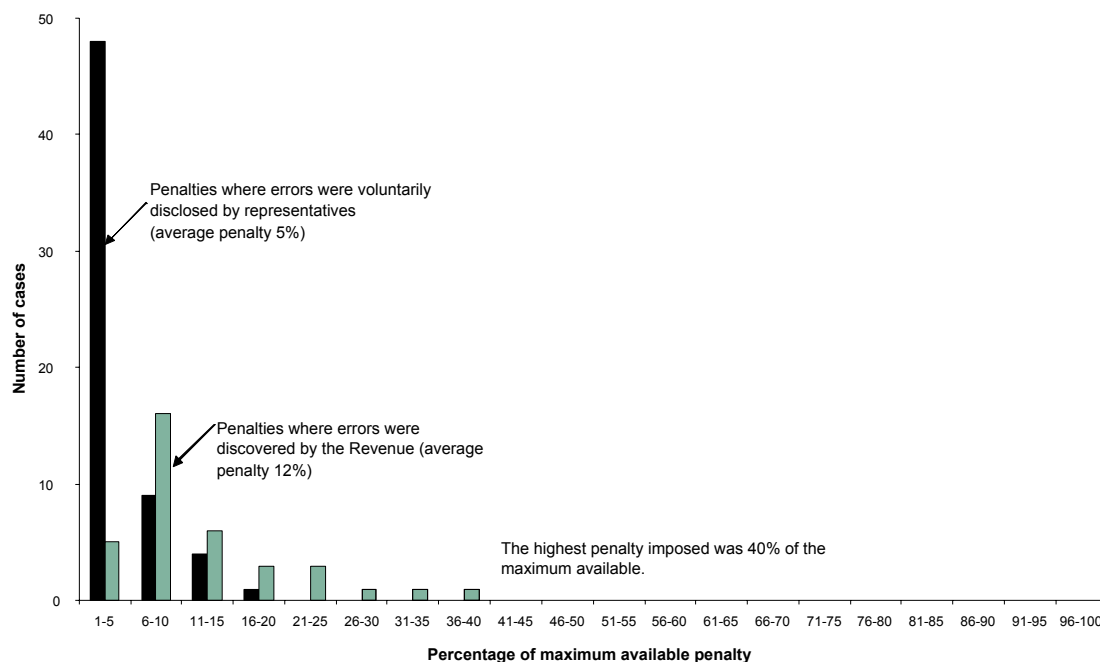
should take a firmer line in penalising representatives for non-compliance and in using new powers in the 1999 Finance Act to obtain the information it required to progress cases. The Act also increased penalties for negligence and fraud. After an initial rise, however, the Revenue has applied fewer penalties for negligence in recent years, and in 2003–04 applied them in only 100 cases. The Revenue has recently secured its first successful prosecution for Inheritance Tax fraud, and other cases are currently under investigation.¹⁴

9. The Revenue attributes the level of sanctions to several factors. These include the inherent difficulties in establishing culpability when representatives are trying to deal with the financial affairs of someone who has died, as well as the deterrent effect of publicising and operating a penalty regime which professional representatives perceive to be tougher. The Revenue has discretion to abate the maximum available penalty according to the gravity and nature of the offence, including whether errors have been voluntarily disclosed and the extent of cooperation from the representative. It used abatements to give an incentive for representatives to disclose voluntarily errors which the Revenue might not otherwise discover, and to encourage full and swift resolution of cases which have had inaccurate returns. In practice, the level of penalties awarded has been well below the maximum available even in cases where the Revenue discovered the negligence. In 2003–04 the penalties the Revenue imposed in cases where representatives voluntarily disclosed errors were on average 5% of the maximum available, and the average penalty it imposed in cases where it discovered the negligence itself was 12% of the maximum available (**Figure 2**).¹⁵

14 C&AG's Report, para 2.11, Figure 13; Qq 7–8, 11, 60

15 C&AG's Report, Executive Summary para 7, paras 2.13–2.14; Ev 11–12; Qq 10, 62, 64

Figure 2: Percentage of the maximum available penalty applied in negligence cases, in 2003–04



Source: C&AG's Report, para 2.16; Ev 11–12

Caseload management

10. In 1999 the Committee recommended that the Revenue should settle cases more quickly, and in particular the longer outstanding cases. In 2003–04, it settled 90% of cases within 12 months, compared to 82% within 15 months in 1999. This improvement has been achieved with a similar level of staffing and during a period in which the overall Inheritance Tax caseload has grown by over 60%. The Revenue has also made progress in reducing the backlog of long-outstanding cases, more than halving the number over ten years old. Nevertheless in June 2004 there were still nearly 900 cases over three years old and 83 over ten years old.¹⁶

11. The Revenue seeks to strike a balance between settling cases quickly and securing the right tax yield. Some cases can be delayed by disagreement or uncertainty over the assets to be included in an estate, or their valuation, or while the Revenue obtains the information it requires. Since 1999 the Revenue has used its new powers of direction to require information on 82 occasions, securing better co-operation in virtually all of these cases. The threat of issuing directions has also made it easier to progress other cases. The Revenue confirmed that the oldest cases have taken a long time to settle because of their complexity, with litigation or third parties typically involved. It was however considering setting a tougher benchmark of settling all cases within two years rather than three years.¹⁷

¹⁶ C&AG'S Report, Executive Summary para 14, paras 2.3, 3.7; Ev 12–13; Q 48

¹⁷ C&AG's Report, para 2.13; Ev 12–13; Qq 50–51, 54

2 Making the tax procedures easier for representatives

12. Representatives of estates fall into two main groups: professionals appointed by the deceased such as a solicitor or accountant; and personal representatives, often a relative of the deceased. The latter group usually have little experience of dealing with Inheritance Tax matters, and some engage solicitors or other professionals to prepare the tax return and administer the estate, the costs of which are met from the estate. Around 30% of Inheritance Tax returns are submitted by personal representatives. It is therefore important that the Revenue makes it as easy as possible for representatives to deal with the tax and meet their obligations.¹⁸

The ease-of-use of the tax returns

13. All government departments should minimise the burden which their forms impose on citizens.¹⁹ In recent years, the Revenue has made efforts to improve and simplify the Inheritance Tax forms, for example by rationalising the main tax return and introducing a shorter, easier to complete, form for the majority of estates. The main Inheritance Tax form, which will continue to be used in over 37,000 cases a year, remains difficult to complete and the Revenue could simplify the technical and complex language, and change the layout to make it more relevant to users. In recent reviews of its forms the Revenue has consulted solicitors and other professionals, but not non-professionals who are more likely to experience difficulty in completing them.²⁰

14. The Revenue is considering whether to introduce an electronic filing service for Inheritance Tax returns. This would make it easier for the Revenue to check returns and to assess the compliance risks, and make the submission of forms easier for some representatives. The benefits are less clear, however, for those who need to use the main form, and often have to submit supporting documents such as a copy of the Will.²¹

Guidance for representatives

15. The Revenue provides guidance notes and information on its website to assist representatives in completing the tax return. It has also launched a joint probate/Inheritance Tax telephone helpline which has been well-received. In response to the C&AG's Report, the Revenue has made it easier to access information on Inheritance Tax on its own website and it is working with other government departments to improve the information available on their websites. It is also considering, with other departments,

18 C&AG's Report, para 3.1; Q 13

19 26th Report from the Committee of Public Accounts, *Difficult forms: how government departments interact with citizens* (HC 255, Session 2003–04), Recommendation 1

20 C&AG's Report, paras 3.2–3.3, Figure 17; Q 12

21 Q 59

launching a ‘bereavement journey’ website that provides a full range of information and advice for people when dealing with the death of a relative.²²

16. Recent feedback to the Revenue showed that only 36% found its guidance notes easy to understand. Some representatives were uncertain about how to value property for Inheritance Tax purposes, paying for professional valuations when a broader estimate may suffice. The Revenue is looking at whether it could do more to highlight the availability of some websites, such as the Land Registry’s online database, that representatives might consult. There is also uncertainty about how properties funded by Islamic mortgages should be valued for Inheritance Tax purposes. Use of these mortgages is expected to grow in future, but at present the Revenue deals with relatively few cases on an individual basis, rather than by issuing general advice.²³

Payment terms

17. The Probate Service does not grant probate until Inheritance Tax due is paid. This is an important safeguard in ensuring tax returns are submitted, but representatives have often needed a loan to pay the tax, with the interest costs met from the estate after probate. To alleviate this, the Revenue allows payment by instalment of the tax due on property and some other assets. Since 2003 representatives have also been able to use funds held in an estate’s bank accounts to pay the tax due before obtaining probate. Some estates may nevertheless have insufficient liquid assets for representatives to pay the tax in advance of probate, if for example the main asset is the family home. The Revenue considers that estates usually do have enough liquidity to pay the tax due, but it has not analysed those potentially affected.²⁴

22 C&AG’s Report, para 3.4; Qq 34–35

23 C&AG’s Report, paras 3.3–3.4, Figure 18; Qq 36, 58, 98–99

24 C&AG’s Report, Executive Summary para 13; Qq 20–21

3 The heritage exemption

18. Assets can be exempt from Inheritance Tax if they are of sufficient heritage importance, on condition that owners undertake to conserve the land, buildings and chattels and to provide reasonable public access. The 1998 Finance Act introduced a more rigorous regime for granting heritage exemptions, raising the quality criterion to ‘pre-eminent’ heritage importance and requiring some degree of open access for the public without a prior appointment. In response to the Committee’s recommendations in 1999, the Revenue and heritage agencies have worked together more closely in checking that exemption conditions are being met, and there has been less slippage in the programme of inspections. The Revenue has also used its website to publicise exempt assets and public access arrangements and it has extended its register of assets to include chattels as well as land and buildings.²⁵

19. Under the 1998 Act the Revenue has proposed changes to introduce open access for some of the 1,000 by-appointment-only agreements that were already in place. It has so far renegotiated agreements with 16 of the 44 owners who between them hold the majority of exempt items, to provide open access to 1,900 chattels. The cases of two other owners who declined to provide open access were considered by the Special Commissioners in 2004, who did not uphold the specific variations proposed but confirmed the principle that the Revenue could review existing undertakings. Because of the lower quality test for heritage chattels that operated before the 1998 Act, the Revenue is unlikely to press for all access agreements to be changed. But it plans to negotiate open access where justified.²⁶

25 C&AG’s Report, Executive Summary paras 17–19 and paras 4.2, 4.9; Q 37

26 C&AG’s Report, Executive Summary para 18; Ev 13

Formal minutes

Wednesday 6 April 2005

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan

Mr Ian Davidson

Mrs Angela Browning

Mr Alan Williams

The Committee deliberated.

Draft Report (Inheritance Tax), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 19 read and agreed to.

Conclusions and recommendations read, amended and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Twenty-ninth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

[Adjourned.]

Witnesses

Wednesday 15 December 2004

Page

Mr Paul Gray, HM Revenue and Customs, **Mr Jonathan Leigh-Pemberton**, and
Mr Gabriel Makhlouf, Inland Revenue

Ev 1

List of written evidence

Inland Revenue

Ev 11

List of Reports from the Committee of Public Accounts Session 2004–05

First Report	The management of sickness absence in the Prison Service	HC 146 (<i>Cm 6496</i>)
Second Report	Tackling cancer in England: saving more lives	HC 166 (<i>Cm 6496</i>)
Third Report	The BBC's investment in Freeview	HC 237
Fourth Report	Improving the speed and quality of asylum decisions	HC 238 (<i>Cm 6496</i>)
Fifth Report	Excess Votes 2003–04	HC 310 (<i>N/A</i>)
Sixth Report	Excess Votes (Northern Ireland) 2003–04	HC 311 (<i>N/A</i>)
Seventh Report	Foreign and Commonwealth Office: Visa entry to the United Kingdom: the entry clearance operation	HC 312
Eighth Report	Ministry of Defence: Battlefield Helicopters	HC 386
Ninth Report	The Drug Treatment and Testing Order: early lessons	HC 403
Tenth Report	Welfare to work: tackling the barriers to the employment of older people	HC 439
Eleventh Report	Improving public transport in England through light rail	HC 440
Twelfth Report	Helping farm businesses in England	HC 441
Thirteenth Report	Ofgem: The Social Action Plan and the Energy Efficiency Commitment	HC 442
Fourteenth Report	Department for International Development: responding to HIV/AIDS	HC 443
Fifteenth Report	Managing risks to improve public services	HC 444
Sixteenth Report	Department of Health: improving emergency care in England	HC 445
Seventeenth Report	London Underground Public Private Partnerships	HC 446
Eighteenth Report	Financial management of the European Union	HC 498
Nineteenth Report	The accounts of the Duchies of Cornwall and Lancaster	HC 313
Twentieth Report	PFI: The STEPS deal	HC 553
Twenty-first Report	The United Kingdom's civil space activities	HC 47
Twenty-second Report	Facing justice: tackling defendants' non-attendance at court	HC 103
Twenty-third Report	Reducing crime: the Home Office working with Crime and Disorder Reduction Partnerships	HC 147
Twenty-fourth Report	Improving patient care by reducing the risk of hospital acquired infection: a progress report	HC 554
Twenty-fifth Report	Tackling congestion by making better use of England's motorways and trunk roads	HC 134
Twenty-sixth Report	Ministry of Defence: the rapid procurement of capability to support operations	HC 70
Twenty-seventh Report	The impact of the Office of Government Commerce's initiatives on the delivery of major IT-enabled projects	HC 555
Twenty-eighth Report	Network Rail: making a fresh start	HC 556
Twenty-ninth Report	Inheritance Tax	HC 174

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 15 December 2004

Members present:

Mr Richard Allan
Mr David Curry
Mr Brian Jenkins

Jon Trickett
Mr Alan Williams

In the absence of the Chairman, Mr Alan Williams was called to the Chair

Sir John Bourn KCB, Comptroller and Auditor General, National Audit Office, further examined.

Mr Brian Glicksman, Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL: Inland Revenue: Inheritance Tax (HC 17)

Witnesses: Mr Paul Gray, Deputy Chairman, Inland Revenue, **Mr Jonathan Leigh-Pemberton**, Director, Capital Taxes, and **Mr Gabriel Makhoulf**, Director, Capital & Savings, Inland Revenue, examined.

Q1 Mr Williams: Mr Gray, welcome to our hearing this afternoon which, as you well know, is on Inheritance Tax. Mr Paul Gray, the Deputy Chairman of the Inland Revenue, is our principal witness. Would you introduce your two colleagues to the Committee.

Mr Gray: On my left is Gabriel Makhoulf who is the Director, Capital & Savings in the Inland Revenue, and on my right is Jonathan Leigh-Pemberton, who is the Business Director Capital Taxes, also in the Inland Revenue.

Q2 Mr Williams: This is really a follow-up to a hearing we did in 1999 and I am glad to see that quite a few of the recommendations that were made by that Committee, which was quite contentious if I remember correctly, have been implemented. Can you tell us why we cannot follow the American good practice in terms of assessing the performance of your department by having a concept of a tax gap? They estimate the gap between theoretical Inheritance Tax, or whatever they call it in their country, and actual receipts is a gap of 13%. It at least gives one a measure of efficiency of delivery insofar as it is a reliable statistic. Why have we not been able to do the same?

Mr Gray: Can I thank you first, Mr Williams, for your welcome for the progress we have made since the last Report. We would very much like to be able to make progress in measuring the tax gap across the whole range of our direct taxes, including Inheritance Tax, and we welcome the recommendations and some of the suggestions from the National Audit Office in their Report. There is no lack of will or desire on our part here. This is technically, though, very difficult territory. As I think our American colleagues would acknowledge, I do not think they feel desperately confident about the precise accuracy of the figure

they came up with which you mentioned. That was based on a survey that was done as far back as 1992 and I do not think they have been able to repeat the exercise since. All that said, we do want to build on their experience. We are committed and indeed have already started to do a broadly similar random selection exercise of around 100 cases which will build on and draw from the experience of our American colleagues. However, I would not want to lead the Committee to think that we are at all easily going to come up with a precise and reliable estimate. There is a general problem right across the direct taxes as distinct from the indirect taxes collected by Customs and Excise where there is much more matching data you can draw on, for indirect taxes you can use data about consumption, then see how much you are gathering from tax, and then do calculations to see what the difference is between the two. With direct taxes and wealth taxes in particular we are rather short of data. Indeed, whereas in the United States our counterparts have been able to draw on wealth data from elsewhere in their governmental system, we are in rather the reverse position in that our own Office of National Statistics uses such information as we have got on wealth as the most reliable estimate available, so there are data problems. All that said, we are committed to doing our best to estimate the tax gap and we have got work in hand to do that.

Q3 Mr Williams: I am inclined to say that your multiple caveats are a good investment for your reception here next time because you have not given us anything we can hold you to, to say "why did you not do what you were going to do?"

Mr Gray: We are promising to do the random sample.

 Inland Revenue

Q4 Mr Williams: You can see from our point of view that if it is practical, we feel it could be helpful in directing your targeting and your compliance work. We accept the general principle and we will give you another try and ask you again the next time you are here.

Mr Gray: Thank you.

Q5 Mr Williams: Something that has emerged relatively recently, which is different from how taxpayers in other areas have been advised and helped, is a series of schemes peddled and advertised in newspaper articles which seem to be legitimate avoidance schemes, and people pay a lot of money to solicitors to sign up to these things and then you come along and pass an Act that invalidates them. I am not questioning the appropriateness of doing that but is there not a way of giving some warning very early on, knowing the temptation there may be for people to rush into heavy commitments with solicitors? You do it in other areas of taxation. Could you not have issued earlier warnings that you really were going to be looking very closely at these schemes and advise them to be very, very cautious about them?

Mr Gray: In relation to Inheritance Tax we seek to adopt exactly the same approach as we adopt right across the direct tax spectrum. Frankly, it is an asymmetric approach which we adopt. Where people come to us and seek clear guidance in relation to schemes which we are entirely clear fall well within the existing tax law, we are content to confirm that our interpretation is that those schemes represent perfectly reasonable tax planning. When we are at the other end of the spectrum and we have people coming to us who are seeking to, how shall I put it, press us to the point of defining precisely what the limits are of legitimate tax planning and what represents artificial schemes then, frankly, we have taken the view in Inheritance Tax and in the other direct taxes that the Inland Revenue is not really here to help people plan to the very limits of what we will accept. So it is an asymmetric approach. Where we think people come to us with something which is well within normal tax arrangements we are content to confirm that. If people are pushing us on how far the limits are pushable, then we really do not think it is either sensible or wise for us to be seeking to give precise interpretations, not least because there is always a possibility, as Ministers have made clear on a number of occasions, of legal changes of the sort you referred to in your question, if the view is taken that particular schemes are clearly pushing into the area of artificiality.

Q6 Mr Williams: You can understand the frustration of people who are wanting to do the legal thing and at the same time wanting to get what they see as the best thing for their families and wanting as firm advice as is practicable. Okay. To move on to the other end of the process now, the penalty system. You seem to be singularly compassionate to the people whom you find guilty of misdemeanours in the way they deal with Inheritance Tax. Penalties

that average just 7% of the maximum seem hardly to verge on the edge of deterrence. How does it come about that the penalty level is so low?

Mr Gray: Again in the Inheritance Tax area we are operating the same sanctions and penalties regime that we operate across the board on direct taxes, so our approach on this particular tax does not fundamentally differ from other areas and we have a recognised tariff, if I can put it that way, of deductions from penalties that are made to reflect various considerations that come to light in particular cases.

Q7 Mr Williams: So has anyone been unfortunate enough to pay the full 100%?

Mr Gray: I will refer to my colleagues in a minute. I think there are relatively few penalties at the 100% level but of course what has happened very recently is that at the far end of our sanctions regime we have secured the first fraud prosecution in this area—

Q8 Mr Williams: —I was going to come on to that.

Mr Gray: —which has now incurred a very heavy penalty. I hope that underlines that we are seeking to operate a spectrum here and the underlying purpose is how can we best develop deterrence and compliance over time.

Q9 Mr Williams: There is a big jump between 7% and being done for fraud. Rather than answering now you might be able to give us a figure or a graph showing what proportion of people pay what proportion of the maximum penalty.

Mr Gray: We could certainly do that.¹ I do not know whether either of my colleagues want to offer some broad figures.

Q10 Mr Williams: A ballpark figure would be quite helpful in case we want to follow up on it. Do many go beyond 50%, for example?

Mr Leigh-Pemberton: The short answer to that is no and the reason for that is because of the underlying behaviour here because we are not talking about people dealing with their own affairs, it is personal representatives trying to make sense of a deceased person's affairs and there are usually several beneficiaries. The vast majority of people administering estates are just trying to do the best possible job they can and most infractions are consequently minor. We take comfort from the fact that as part of this review the National Audit Office themselves asked us to look at cases where we had not pursued a penalty but thought about it. As you will see in the Report, they were content that the mitigation that we were applying was correct and in line with general policy in the Department on penalties.

Q11 Mr Williams: Before I go on to Mr Trickett, on the point you have raised of the one case of fraud, is it not rather remarkable that there has only been one case?

¹ Ev 11–12.

 Inland Revenue

Mr Gray: I think it reflects the fact that in complex cases the process of investigation can be extremely extended. That particular case was under investigation for a good number of years. What I would say is—and obviously I am not able to refer to specifics—there are a number of other cases currently under investigation. Depending on the course of those investigations they may or may not lead to prosecution. We are certainly not viewing the Lamberton case as a sole example of using that far end of the compliance spectrum.

Mr Williams: Can I just say before I call Mr Trickett I know that you are trying to be helpful and you are giving full and very helpful answers, but I do not time limit myself in the chair, it is a luxury I indulge in, but my colleagues are time limited so if you can give succinct answers that would be helpful to them. Jon?

Q12 Jon Trickett: I have just had the experience of bereavement with my mother's death in April this year when I helped my dad to fill in the forms. As the Report describes, the forms are not straightforward at all. IHT205 is meant to be the short form (which is applicable to the vast bulk of all estates) and although my mother did not leave enough money to pay tax we found that we were able fairly easily, within just over an hour, to complete IHT205, only to find a circularity about the form because almost the last point on the form was "now go to IHT200 (which is the longer form) because your mother's estate now requires you to go and do that". That was an intensely irritating thing given the fact we had just been bereaved and were going through the complex financial situation that any person leaves. IHT200 was beyond our capacity, frankly, and myself and my father are not illiterate or innumerate people. In the end we had to employ someone to fill the form in and, frankly, that was a professional accountant working in a large practice in the centre of Leeds which does have some top-class accountants. They themselves prepared the form, filled it in, and it was returned twice because it had been filled in incorrectly. The form itself is not as clear as it ought to be. Finally, we ran into trouble, after all that had been done, with the probate where there were further problems. It is not good enough, is it? It is not satisfactory that people are having to employ specialists to fill forms in when really this should be a family matter particularly at a time of bereavement? Why is it that the form is so complicated?

Mr Gray: I am naturally very sorry to hear about the case that you had to go through. We have sought to make quite strenuous efforts over recent years both to improve and simplify form design and reduce the number of people who do have to fill in the longer form. I obviously cannot comment on your particular case—

Q13 Jon Trickett: I am not asking you to but I think 70% of all people who have to fill in IHT200 are employing specialist help, so there is money going out of the family in the vast majority of cases. Is it

not right that that is the case? They are having to employ specialists to fill in forms which really should be a fairly simple and straightforward matter?

Mr Gray: 70% of those who need to fill in the form are indeed using professional advisers but the proportion of total bereavements where it is necessary for people to fill in the full form is now significantly reduced as a result of the action taken.

Q14 Jon Trickett: How many of those people who are not filling in the 200 form are also having to employ people to do it for them?

Mr Gray: We would hope that very few are.

Q15 Jon Trickett: You do not know then?

Mr Gray: Because they are in the position of finding through the probate process that that is automatically resolving the matter for them and they do not need to fill in the form.

Q16 Jon Trickett: First of all, I am not sure that what you are saying is correct. Do you find that there are problems frequently between yourselves and probate even when the forms have been completed for yourselves and there are further complications with filling the forms in and satisfying the demands of probate?

Mr Gray: I think I can honestly say the experience you referred to is not something that we find all that typical. Usually the degree of complementarity and successful co-operation with the Probate Service is very high but obviously I am very sorry to hear about this particular case having been so difficult.

Q17 Jon Trickett: All I know is that when you have specialists in large accountancy firms failing to fill in the form correctly it tells you that it is not the human beings involved it is the complexity of the form itself. Can I just go on to another matter which is this business of having to pay tax before probate is issued. It did not affect me in my particular case but it was obvious that had I inherited a property from my mother which had been above the tax threshold and had she not left any money in the bank, the family would have had to find the liquidity to pay the tax before probate would have been issued. We would not have the authority to sell the house in order to raise the money to pay the tax but you yourselves would have wanted the tax prior to probate. Is that correct?

Mr Gray: It depends on the type of case. We have sought to increase the number of cases where it is possible to avoid that, for example with the introduction of the direct payment scheme for banks.

Q18 Jon Trickett: Paragraph 3.6 on page 29 says: "Once any tax assessment is agreed with the Revenue, representatives"—I presume that is of the bereaved—"need to pay any tax due before probate can be granted and assets in the estate distributed". There must be many people whose largest single asset is a house which they bought for probably not a large amount of money and over the years they have lived there it has gone beyond the tax threshold. This

 Inland Revenue

is affecting many older people and middle class people and so on, it not just the very, very wealthy. In those cases one can imagine there is frequently not a large amount of money left in the bank at the end of a life. If you cannot sell the house and there is not enough money in the bank, and in any event you cannot get access to the money because probate has not been issued, then literally the family is thrown back onto its own resources to go to a bank or elsewhere to pay the tax because probate has not been granted. Is that not grossly unfair?

Mr Gray: There are a number of points. Firstly, we are only talking about 5% of bereavements where any Inheritance Tax is being paid. You refer to paragraph 3.6. The bullet points later in paragraph 3.6 do spell out a number of measures we have taken over the last few years to seek to mitigate that problem in cases where it arises, for example through the direct payments scheme in the first bullet of 3.6, and there is a point in the bullet at the bottom of that page around the provision where a payment does need to be made but can be settled in annual instalments, so we are seeking to mitigate that.

Q19 Jon Trickett: That third bullet point does not make it clear whether that is before or after probate.

Mr Leigh-Pemberton: The instalments are paid over ten years after probate is granted, as long as you have met the requirements and agreed the instalments with us.

Q20 Jon Trickett: Are there many cases where this is an issue?

Mr Leigh-Pemberton: There is a reasonable number of cases where people pay instalments but most—

Q21 Jon Trickett: Where it is an issue, where there is not enough liquidity within the family to pay off the tax?

Mr Leigh-Pemberton: No, there is usually enough liquidity to meet the requirement.

Q22 Jon Trickett: Finally, Figure 6 on Page 12 refers to a number of ways by which one can manage Inheritance Tax liabilities. One of them I was not aware of but I read it with some interest. It is possible to attract 100% relief if the person who subsequently dies invests the money into particular kinds of company held by a beneficiary, such as agricultural companies and others. If I, for example, invested £100,000 in a company which was simply a device and then were to die, it looks as though that is tax exempt. Is that correct and what steps do you take to ensure that this is a properly trading company?

Mr Gray: We do take steps through our compliance arrangements to do that. The whole point about these arrangements, which are entirely appropriate tax planning and mitigations which we certainly make no secret about, is that they are intended for genuine transactions. If they were entirely artificial transactions then through our compliance effort we would be seeking to stamp that out.

Q23 Jon Trickett: In a farm or agricultural business it is fairly obvious but in terms of a company which one might set up do you establish that the company is a trading company and is operating and has been there for a number of years?

Mr Leigh-Pemberton: Yes we do.

Jon Trickett: Thank you.

Mr Williams: Richard Allan?

Q24 Mr Allan: I wanted to focus initially on the issue of house prices. We see in Figure 11 on Page 20 that the rise in house prices is going up quite sharply at a time when the Inheritance Tax threshold has only risen very gently. The Report states that this does mean that lots more properties come within the Inheritance Tax threshold. This is obviously one of the most sensitive areas for the public out there. Can I start firstly by clarifying the position. There is a case study on Page 11, Example 1, of somebody leaving their property and having an infirm son in the property. This is a classic difficult case which one would have to deal with as a representative. If somebody does die and their property value has gone up to £400,000, say, and they have a non-spouse relative living in that property, that non-spouse relative will be liable for Inheritance Tax at the time of death. That is the normal situation; is that right?

Mr Gray: Yes.

Q25 Mr Allan: So they are faced with a situation of having to potentially sell the property to pay the Inheritance Tax liability?

Mr Gray: What Case 1 brings out is the arrangements we do make where there is a clear stake in the property by somebody else to mitigate that effect.

Q26 Mr Allan: That was a clear statement where the deceased said in their will, “I want my son to carry on living there”. Does there have to be such a clear expression or could it be that if it is a person who was not worldly wise, who had not got accountants and lawyers, a regular citizen, so can you make that assumption on their behalf that they wanted that to happen and therefore give them an exemption?

Mr Gray: Given the state of the law, each case would have to be looked at on its merits which was I think the case in Case Example 1.

Mr Leigh-Pemberton: That is correct. The rights arise from principles of equity so we would look at the facts and determine the value accordingly and they would not necessarily have to make specific provision. It would depend on the facts of the case.

Q27 Mr Allan: Here it just happened to be that they wrote it in the will but that is not essential?

Mr Leigh-Pemberton: It is case specific.

Q28 Mr Allan: It says that the value of the house is £275,000, the stake was valued depending on the life expectancy of the son at £100,000, reducing the estate's tax liability by £70,000. Can you explain the

 Inland Revenue

maths to me or is that an unreasonable request? I cannot get the sums. Why is the liability reduced by £70,000 when the guy's stake is valued at £100,000?

Mr Gray: That is a good question to which I cannot give you an immediate answer but I will let you know.

Q29 Mr Allan: We will leave that one floating around in the air. The more typical situation is that there are two spouses living in a house and again the property value has gone up. It may be £400,000 or £500,000. The two spouses want to maximise their Inheritance Tax exemption cover so they now come to arrangements whereby the first spouse who dies sets up a trust to make sure that they get the full £525,000-worth of cover. Is that strictly legal? Is that currently a situation that is fine?

Mr Leigh-Pemberton: Yes, that is legal.

Q30 Mr Allan: Will that continue to be so or are they intending to change that so again we look at that as a potential tax avoidance scheme?

Mr Leigh-Pemberton: That would be a matter for Ministers and Parliament.

Q31 Mr Allan: But at the moment that is the *status quo* and there are no proposals to try and change that?

Mr Leigh-Pemberton: Yes.

Q32 Mr Allan: The number of people taking advantage of that has increased as house prices go up and we can expect to see that continue to be a feature?

Mr Leigh-Pemberton: Inevitably we do not really know what people have done until they have died so we do not know precisely what arrangements they have got, but that is not an unreasonable assumption.

Mr Gray: There has certainly been a degree of publicity given to that arrangement and it has been made clear that we regard that sort of straightforward arrangement as well within the existing framework.

Q33 Mr Allan: Just to clarify for my own purposes as well, anything that is given away to any family member more than seven years before a person dies is completely exempt, it is not taken into consideration at all so, again the parent with the infirm son if they gave that house to their son and then survived by more than seven years, would that cause any problem at all?

Mr Gray: The seven-year rule is a pretty straightforward one and clear-cut and that is the time limit laid down in the legislation which we implement. It crucially depends which side of the dividing line of the seven years it proves to be that the person dies.²

Q34 Mr Allan: I am grappling and trying get through it and understand it but let's move on to some of the recommendations around the web site and web site understanding for people to take them through this. There are a number of recommendations in here about pulling information together. One of the things that the National Audit Office has done for us is to expose the level of complexity and I think Mr Trickett's questions were going along similar lines. What plans have you got to try and ensure that Mrs Smith can find easy sources of information, can understand about valuation, can understand the seven-year rule and what they need to do in order to make sure that they are not caught unnecessarily by Inheritance Tax?

Mr Gray: In relation to material on the web site we welcome the dialogue we had with the National Audit Office and some of its specific recommendations. Since the Report was under preparation we have made significant steps to improve the way the web site operates. We have brought the separate pages on Inheritance Tax together. If you go into our home page you are only two clicks away from getting an integrated viewing of Inheritance Tax. We are also working across government with the Directgov project which is seeking to bring together more joined-up information on line. We face a slight dilemma there in that we are linking up with other people's web sites and we cannot be in a position of giving a full guarantee and assurance about their accuracy, so we are having to tread a little bit carefully on that but it is very much the direction of travel in which we want to move and we quite accept that although we have made some improvements over recent years, there is more to be done, and we are on the case.

Q35 Mr Allan: Have you got life event things where I can go in and ask the direct question: "A relative has died . . ." and then it links into you as well as all the other things I need to do?

Mr Gray: I do not think at this stage we have got to that point but we are actively involved in discussions with other government departments around the notion of the bereavement journey, if I can put it like that, to address exactly that issue, that this is a life event that we with other arms of government have scope for getting better at offering a joined-up service. I think what we have done with the Probate Service helps in that regard but there is scope to do more.

Q36 Mr Allan: Do you offer clear guidance on property valuation? Something that seemed to come out was that people are still confused about where they should go and what is acceptable or will it remain the case in statute that somebody gets a valuation and you can challenge it, so there is no fixed formula for it?

Mr Gray: We are talking about a whole range of different types of property and the basic principle which we seek to operate, and will continue to operate, that this reflects a fair current market value. When you are dealing with assets whose value fluctuates in one direction or another, inevitably

² *Note by witness:* This applies to an outright gift, ie where the donor ceases to enjoy the gifted property. Where that is not so, the "gift with reservation" rules would treat the property as remaining part of the donor's estate.

 Inland Revenue

there will be cases where we are reserving the right to challenge particular valuations that have been offered.

Mr Leigh-Pemberton: We do give specific advice on how to approach valuations of residential property which affect most people and we are looking at the recommendation about whether we could do more on that side, particularly if there is information from the Land Registry that we could make available.

Q37 Mr Allan: A final area I want to look at is the Heritage Exemptions. You will be aware that there is criticism of these that pops up from time to time when newspapers try to gain access to things that are supposed to be accessible and find that they cannot. You were asked to make progress on this in earlier Reports as well. Can I ask how you now feel about the monitoring you do of the access to items that should be accessible because you have given a Heritage Exemption?

Mr Gray: I think we have made very significant improvements since the Committee last looked at that. We have ensured that through regular process of five-yearly inspections and the questionnaire that we are now getting much higher compliance on that with the partners we work with. Of course since the 1998 Finance Act we are now operating a more rigorous regime in granting heritage exemptions over the terms of those exemptions so I think we are making quite a lot of progress.

Q38 Mr Allan: If a member of the public went to a web site and found there was an item they wanted to go and see and they could not get to see it, who would they tell?

Mr Gray: We would encourage them to tell us.

Q39 Mr Allan: You would be the complaints body for that?

Mr Gray: Yes.

Q40 Mr Allan: Do you have to link up with heritage bodies like English Heritage?

Mr Gray: We have links with all of the relevant heritage bodies, some of whom act on our behalf in our policing.

Q41 Mr Allan: What is the Inheritance Tax situation on an item that was donated to a museum as opposed to kept in possession and made accessible? I have got a painting or an historical object that I want to donate; am I still liable for the tax even though I am donating?

Mr Gray: It depends on its quality in that since 1998 it will need to be of “pre-eminent quality” in order to qualify. I think I am right in saying that that is the key test and whether it is placed in a museum or elsewhere is a secondary issue.³

Q42 Mr Allan: If it were donated to a museum that was a charity and the museum wanted it, would that fall under a Charitable Exemption?

Mr Gray: Yes.

Q43 Mr Allan: So it could be either heritage or charitable?

Mr Gray: Yes.

Q44 Mr Jenkins: Can I take Case 1 to start with. As I understand Case 1, the person who left the estate had above the minimum requirement, so a £275,000 house would be fully taxable and they would be paying £110,000 tax on that segment of their estate. Because they were allowed to re-establish the value of this house at £100,000, the tax then due on it would be £70,000 less because they did not have to pay tax on the £175,000 amount at 40%. That is how it works out. Is that right, Mr Gray?

Mr Gray: I think that is right. I did not quite hear every word of that.

Mr Jenkins: It is the difference between the actual valuation of £100,000 which they paid £40,000 tax on because this estate was above the threshold and what they would have paid tax on. The original tax on £275,000 was £110,000, and the difference between the two is £70,000 which is 40% of the £175,000 revalued.

Mr Allan: Thank you.

Q45 Mr Jenkins: You are welcome.

Mr Gray: Thank you for answering the question for me.

Q46 Mr Jenkins: I am not a tax inspector. When you read this report you must have been fairly pleased, were you not?

Mr Gray: I was reasonably pleased, yes.

Q47 Mr Jenkins: I thought it was an excellent report.

Mr Gray: There was good progress on nearly all the recommendations.

Q48 Mr Jenkins: Very good progress, especially when I look at the backlog on Page 30, paragraph 3.7. You have dropped from 2,000 cases over three years old down to 882 and from 200 over 10 years old down to 83. That is tremendous progress in the amount of time we have been tackling this. Is that progress down to the fact that you have got to being more efficient, or that you have got more staff working on this backlog of cases, or are we just looking at a laxer regime?

Mr Gray: More efficient and more effective at the way we work across the different parts of the Inland Revenue. The number of staff engaged in this area of tax has been broadly unchanged at around 400 over the period. The caseload has gone up by something like two-thirds and the flow of new cases has gone up by something like two-thirds and we have managed to reduce the backlog, so I think it is more efficient.

Q49 Mr Jenkins: More efficient, excellent.

Mr Gray: I think we have joined up different bits of the organisation more effectively than previously.

³ *Note by witness:* Gifts and bequests of any assets to museums etc described in Schedule 3 to the IHTA 1984 are exempt from IHT.

 Inland Revenue

Q50 Mr Jenkins: So what further progress are you seeking to reduce the number of outstanding cases beyond that level we have got now?

Mr Gray: We want to go as far we can. One thing we are currently considering is we have used the three-year benchmark as one of the key things to monitor. We are considering, for example, and we have not taken a firm view on this yet, whether to set ourselves a tougher target, and we ought now to be taking two years as a benchmark above which we regard this as a number that we would feel rather embarrassed about.

Q51 Mr Jenkins: That is excellent. Have you established how much tax we have lost because of the long time it has taken to finalise these tax liabilities, where assets have disappeared or are untraceable, or if it is impossible to assess the value?

Mr Gray: We have not got a precise estimate because there is a very difficult balance here, Mr Jenkins. The reason that the great majority of these cases is taking longer is not that they just happen to be at the bottom of the pile, it is that there is a very close correlation with the degree of complexity involved in the cases so we are tackling a very big balance. If we seek to settle the issue very quickly we may underestimate the true liability. On the other hand, there is the risk to which you point but we are trying to strike this balance in a way which gets the case sorted out as quickly as we reasonably can, securing the right yield. I would not accept that there is a big leakage here simply because cases are taking longer.

Q52 Mr Jenkins: Would you not have a feeling that the reason why an individual wished to prolong this case is that he is seeking tax advantage? Somewhere along the line they are trying to pay less tax?

Mr Gray: I think they are looking to minimise their liability through prolonging the discussions with us. There is, though, a countervailing point that the longer it carries on once the liability is settled the greater is the interest payment, so there is an offsetting system.

Q53 Mr Jenkins: Do you have any power, for instance, to use directions to instruct them that they must give you information more quickly?

Mr Gray: Yes.

Q54 Mr Jenkins: Do you use that power?

Mr Gray: Yes we do. I think some figures were brought out in the Report that if we feel we are not getting appropriate help and co-operation we give directions and if those directions are not followed then we have a penalty regime that follows it. I think I am right in saying that we have virtually no cases in which after having made a direction we continue to get a lack of co-operation, so we use that sanction with some effect.

Q55 Mr Jenkins: They tend to be the high value cases?

Mr Gray: Yes, by and large.

Q56 Mr Jenkins: People like visitors to our country who have enjoyed certain tax advantages, if they happen to die we find difficulty tracing their assets?

Mr Gray: I think that is a possibility but I think there is a general correlation here between the more difficult, more complex and probably higher value cases.

Q57 Mr Jenkins: What about the average, the cases of people who are just over the borderline? If you have got a situation where you have got an estimate for the valuation of a property, can we accept the valuation of this property or do we require a fresh valuation with the cost falling back on the person? How would you value the property?

Mr Gray: It depends, as Jonathan was saying just now. We seek to give guidance and advice on how people should secure property valuations but we are not dogmatic about precisely the basis on which it should be done. We reserve the right in looking at a case if we feel the valuation may not be a fair one to ask for a new one.

Q58 Mr Jenkins: Of course but could we assume, for instance, that you would accept a newspaper page of properties of a similar nature and location showing what the market price is? Would you guide us down that road rather than undertaking a full valuation?

Mr Leigh-Pemberton: We certainly do not require people to send us professional valuations as a matter of course. If they have taken a reasonable approach and our colleagues in the Valuation Office confirm that it is a sensible market value, it is accepted. 70% of the cases we deal with are settled within six months and everything is over, so the simple cases you are talking about we deal with as fast as we can because we know the bereaved want certainty.

Q59 Mr Jenkins: That is simple cases. Have you thought about an electronic service for those cases? What are the pros and cons for providing such a service?

Mr Gray: We certainly have thought about an electronic service and we are actively discussing that with others, following up one of the other recommendations from NAO. The pros here are the normal advantages of electronic transmission which we have sought to exploit very heavily in other areas of the direct tax system. The down side and the main difficulty in the IHT case is the need for submission of supporting documents, so although the forms which Mr Trickett was referring to are available electronically and people can quickly print them off the internet and send that in, when there are additional documents required, to do a full electronic transmission we are on to issues of scanning of documents, so unlike a number of other areas of tax where it is simply getting our form completed and doing that electronically, the additional documents are the potential difficulty. We are actively considering how we best overcome some of those obstacles and think about offering that service.

Inland Revenue

Q60 Mr Jenkins: Mr Williams asked you a question about the first prosecution for Inheritance Tax fraud. Surely that is not the first case you have prosecuted?

Mr Gray: It is the first prosecution in relation to Inheritance Tax since the conversion from Capital Transfer Tax.

Q61 Mr Jenkins: Are there any more in the pipeline?

Mr Gray: I sought to indicate to Mr Williams that we certainly have other investigations underway and if they are not satisfactorily resolved in another way we will pursue prosecution.

Q62 Mr Jenkins: Because it seems looking at the penalties you have issued that the average value of the penalties imposed has actually decreased since 1999, when the penalties available to you have increased and the caseloads have gone up as well. Why has that number of penalties fallen? Is that because of the more efficient service providing a faster, closer turn round or because, once again, it is easier and it is maybe a laxer regime?

Mr Gray: We are certainly not operating a laxer regime. We pursue penalties not for the sake of pursuing penalties but as part of the deterrence/compliance regime. The feedback that we have been getting from our increasingly regular contact with the professionals who operate in this area is that they feel we are operating a tougher regime. I think the National Audit Office in the course of their study point to this and external stakeholders in this gave the same feedback, so we feel that we are actually operating a tougher, more deterring, more compliant regime now, and once you get into a more virtuous circle of that sort it gets into prevention rather than cure. If you resort to penalties then it is initially a cure.

Q63 Mr Jenkins: I can almost understand that.

Mr Gray: Only almost?

Q64 Mr Jenkins: I can understand the virtuous circle because the offences are smaller and going down the scale, and therefore the penalties are going down the scale, but I am not quite convinced why the amount of penalties you are imposing, not the number but the amount, should be falling. Of course the professionals would say you are imposing a draconian scheme charging them anything at all, but do you feel that your deterrent effect is heightened by a falling amount of penalty?

Mr Gray: You are talking about the profile of the average penalty which has gone a bit up and down but taking the two years that you did it is now slightly lower. We do feel that as a result of all the things I have talked about and given that our strongest interest is in encouraging people to co-operate with us that it is sensible to take account of the inherent difficulties a lot of people have in dealing with us in mitigating penalties.

Q65 Mr Jenkins: How much tax is lost from undeclared gifts?

Mr Gray: We cannot give you a precise estimate of that. It is part of the general difficulty of understanding the tax gap which Mr Williams started the discussion with us, but we are through our compliance activity looking to crack down on that.

Q66 Mr Jenkins: So we have no estimate at all? We have got no profile, we have done nothing with regard to how much money is transferred between individuals? You have not worked with the Revenue and decided if wealth suddenly moves from A to B there is a suspicion of transferring gifts across? There is no way to track that?

Mr Leigh-Pemberton: We do do that. As a result of the recommendations you made before we did a specific exercise to look at lifetime transfers to see how much of a risk there was, and the figures are reflected in the Report. That gave us a feel for the level of risk. Gifts are likely to be a feature in the larger cases because that is where the liquid wealth is and we are much more joined-up with other parts of the Department so we receive information from them and we use the databases on SA tax returns and we look at changes in income in life that may suggest there have been transfers, so the sort of approach you are suggesting is very much at the core of our compliance work in that area.

Mr Gray: Just to add to that if I may briefly, one area of enhanced co-operation we have is with a relatively new dedicated service we have set up in the Revenue for dealing with high-value individuals and in the case of bereavement of any of those individuals we now have a much more automatic link with that part of the organisation.

Q67 Mr Jenkins: That was what I was going to talk about next. How much extra tax are you getting in now that you are referring all cases of unquoted shares to be checked by the Shares Valuation Division? The second question is how much extra Inheritance Tax has the Special Compliance Office secured from its work on offshore trusts, and what more is to come in these areas?

Mr Gray: In relation to offshore trusts we have had a special spend-to-save scheme in operation since April of 2003, and our latest figures there are that we think we have already secured £11.3 million and there is something like another £7.5 million.

Q68 Mr Jenkins: Is that million or billion?

Mr Gray: Million but that is in return for an additional staff effort of something of the order of £100,000 so this has been a very good investment.

Q69 Mr Jenkins: Yes, spend more money please, let's get more money in! And the shares issue.

Mr Leigh-Pemberton: As the Report says, we make an adjustment of £54 million. We do not actually calculate that through precisely into the tax bill because it depends on where the threshold is on each specific case, but that is a substantial addition in tax.

Q70 Mr Jenkins: Is the pay back for the amount of work involved good?

 Inland Revenue

Mr Leigh-Pemberton: Yes, very good.

Mr Jenkins: Thank you.

Q71 Mr Curry: Do you recall Adam Smith's definition of a good tax?

Mr Gray: I cannot remember the precise quotation.

Q72 Mr Curry: The gist was that it is easy to collect, difficult to avoid, and a high proportion of what is due is collected. On that definition, Inheritance Tax is a lousy tax, is it not? It is a very, very bad tax. There is a very high proportion of avoidance, relatively little of what could be paid is paid—very sensibly I have to add, I am entirely on the side of those who do not want to pay—I am absolutely on the side of those who do not want to pay it, I have to say. It is very, very complicated. Mr Trickett has illustrated that it is massively complicated.

Mr Gray: I am not sure I would accept it is massively complicated. We have sought to streamline the regime over the years.

Q73 Mr Curry: Is it not also a bad tax because the poorer you are above the threshold the more likely you are to pay the tax whereas the wealthier you are above the threshold the less likely you are to pay it?

Mr Gray: I am not sure that I follow that point.

Q74 Mr Curry: The tax threshold for the sake of argument is £265,000. So if my assets when I die are £350,000 or whatever it is, then I am not going to pay Clifford Chance a king's ransom to devise an avoidance scheme for me. If my assets are £3.5 million it is jolly worthwhile employing Clifford Chance or somebody else, is it not? Let's start again. Roy Jenkins said that Inheritance Tax was a voluntary tax and that you had to hate your relatives more than you hated the Inland Revenue to pay it. Would you agree with that?

Mr Gray: I do not really think I wish to comment on that. I think you are raising questions about the policy basis of tax rather than about the administration of it, of which I am in charge.

Q75 Mr Curry: That may be true but I am also raising questions about the efficiency of the tax. Let's look at it in terms of return on capital. It raises about £2.5 billion, or probably a bit more—£2.7 billion or £2.8 billion that sort of thing.

Mr Gray: About £2.8.

Q76 Mr Curry: How much capital is invested in raising that amount of money for the Government. How much does it cost you?

Mr Gray: In terms of our cost of administration, our administrative cost is of the order of 1.2% to collect this tax, which is very broadly in line with the average across most of our other direct taxes, so in terms of administrative cost of collection it is not way out of line.

Q77 Mr Curry: Not out of line with Income Tax or VAT?

Mr Leigh-Pemberton: It is cheaper than Income Tax and the largest estates still pay the largest proportion of the tax.

Q78 Mr Curry: If the threshold were £1 million—and correct me if I am wrong—the tax yield would be down to £400 million, that sort of order?

Mr Gray: Yes, I think there was a Parliamentary answer a month or two ago that suggested that if it was £1 million, the loss of yield would be about £2.5 billion, so we take it down to a few hundred millions.

Q79 Mr Curry: So does the higher the threshold make your return on capital better or worse, as it were?

Mr Gray: I think it is a rather complicated calculation because we are already only looking at a relatively small proportion of the cases. That explains why we have high compliance with relatively low administrative cost. If you were to raise the threshold, I think that calculation would carry through and we would actually need to employ significantly fewer people because a much larger proportion of the cases would be sorted out automatically.

Q80 Mr Curry: It comes from the big numbers in fact.

Mr Gray: Yes.

Q81 Mr Curry: So in terms of efficiency (we are all in the age of Gershon and James and all that) then an increase in the threshold would be a productive return on capital?

Mr Gray: It depends what type of case you are hypothesising and whether there was a reduction in overall taxation of that amount. A counter factor would be the alternative place where the tax would be greater.

Q82 Mr Curry: But the point I am making—and it is not a hostile point to you—is here is a tax where in a sense the poorer you are, within the brackets of poverty described by this tax, the more likely you are to pay it and the wealthier you are the less likely you are to pay it because all sorts of schemes which are listed here—and I am grateful to Sir John for the extremely helpful reference to those schemes—the more likely you are to be able to devise the means to avoid the tax and it is unusual, is it not, to find a tax which is in that position?

Mr Gray: I do not think it is an unusual tax. Most taxes have their distinctive characteristics. This is a tax, which as the Report brings out, is effectively borne by approximately 5% of people who die.

Q83 Mr Curry: But 5% of everybody who dies and some will die below threshold? Or is it 5% of those who die and leave estates above the threshold?

Mr Gray: No, 5% of those who die. There are roughly 600,000 bereavements a year and we are talking somewhere around the 20,000 or 30,000 mark.

 Inland Revenue

Q84 Mr Curry: One of the eternal truths of tax law appears to be that if you create a much simpler tax structure and reduce the incentives to avoid, and even if you reduce the level, your total tax take might go up. We have experiences, do we not, of taxes where the yield has increased because people have said it is not worth all the fuss of trying to avoid it, it is a more reasonable tax?

Mr Gray: Designing any tax system involves those rather subtle tradeoffs.

Q85 Mr Curry: There is a whole set of documents and suggestions that have come forward to transform Inheritance Tax to an annual tax on property and that sort of thing, on the grounds that that would be more transparent and easier to collect than what we have now.

Mr Gray: There certainly have been quite a number of suggestions put forward. I do not think I am the right person, if I might say so, to address those.

Mr Curry: I appreciate that.

Mr Williams: You do not have to answer policy questions.

Mr Curry: It is not policy. I am anxious that the Government should get the best value for money.

Mr Williams: I understand your motives; I am just trying to protect them in case they feel obliged to answer you.

Q86 Mr Curry: Undeclared gifts. Had I, let's say, a Louis XV cabinet come into my possession, which would be worth a bob or two, and I said to my daughter one weekend, "Would you like to put that in the back of the van and take it home?" you would not know a thing about that, would you, because you are not going to check through my insurance to see whether or not that is insured and whether she has put it on her insurance or anything else, are you?

Mr Gray: It rather depends what our compliance—

Q87 Mr Allan: —He will now!

Mr Gray: If you have given us warning we may very well take advantage.

Mr Leigh-Pemberton: The short answer is yes we would if the case suggested that it was sensible to do that. If we see a case—and it is one of the recommendations in the Report that we do this more systematically—where there is a very valuable home and the contents we are told are worth tuppence h'penny, the investigator in us asks some questions and one of the documents we may well look at is insurance documentation, recognising that insurance value is not the same as the market value.

Q88 Mr Williams: May I take it that when you leave here you will immediately open a Curry file?

Mr Gray: I could not possibly comment!

Q89 Mr Curry: I have no present intention of dying but I shall try to make sure that when I do it provides as little interest to you as possible!

Mr Gray: In the very unhappy event of your dying in less than seven years, Mr Curry, had you done such a thing, it is possible, but it depends on our risk profiling at that point when we are considering which cases to press for compliance.

Q90 Mr Curry: The key issue is this graph on Page 20 about the Inheritance Tax threshold and the trend upwards. It is obviously sensible to try and die in a house price slump, is it not?

Mr Gray: From this point of view, yes.

Q91 Mr Curry: It is bad luck really for everybody concerned if you hit the top of the housing market. This graph ends in 2003 or a little before it so there might well have been a peak when the average London house price exceeded the tax threshold.

Mr Gray: We do not have the data.

Q92 Mr Curry: At least it is plausible?

Mr Gray: It is plausible. We all know these indices move around and there has been a suggestion they are moving in the other direction. Whether they have crossed or not we do not really know.

Q93 Mr Curry: But it does mean that over recent years a lot of the people have found themselves within the threshold through having done absolutely nothing to try and enhance their wealth, indeed they may well have problems because they may find themselves asset rich and cash poor because of what has been happening, but simply because property prices have risen by higher than the threshold, so lots and lots of small people in a sense are coming into the net, are they not?

Mr Gray: Well, in relation to the London house price index, which is obviously the one you are referring to, there has probably been some increase, yes.

Q94 Mr Curry: And that is probably true of the South East, the East of England, the South West where there is lots of pressure on housing. Even Hartlepool is a hot spot, would you believe, or it used to be.

Mr Gray: Clearly when you get significant changes in the prices of assets that most people have then you are liable to have that arithmetic effect, but trends move in opposite directions at different times.

Q95 Mr Curry: But the threshold does not?

Mr Gray: That I think is another policy question.

Mr Curry: Thank you very much.

Q96 Mr Williams: Can I follow up on that. I have been scribbling earlier on along similar lines. If you look at that graph you will see that if you take the national house prices index, at 1988 the average price of a house was 120% below the Inheritance Tax threshold, if you look at £50,000 to about £110,000. If you look at the London, it was only 50% below, £75,000 to £110,000. Now if you go to the other end of the graph, as David did, and you look, the non-London is closer but there is still a gap of 40% of house value before it reaches the threshold. But, as

 Inland Revenue

David rightly said, if you look then at the London graph, a year ago it was virtually equivalent to the threshold and most certainly will have passed it in the last 12 months, so that if you are having problems collecting tax from 5% of the population, what is going to happen since the South East will probably broadly reflect London prices, and that contains 25% of the population of the United Kingdom, is that you are suddenly going to see a massive mushrooming in the number of cases that are going to have to be handled, are you not, and the 5% is going to look like the “good old days” of the past?

Mr Gray: I think, Mr Williams, it depends crucially on the future relative movement of those two indices.

Q97 Mr Williams: I am an accountant so I would just take the view in the medium term. Since there is a built-in shortage of housing in the country then there is only one way house prices can go. I am not going to say in any one year but the trend is going to inevitably and inexorably continue to rise above the threshold, so that many, many more people are going to be paying and going along the lines David wanted to do (and I must be careful not to get drawn into policy ends meandering). You talk of the tax’s yields but they are becoming increasingly anomalous. The mega-wealthy are being allowed exemptions and for an apparently morally justifiable reason you cannot comment on that, but the result of what is happening is because their houses are going up in price and they would be dearer anyhow they will have the escalation of the house values and their houses will be caught, as will everyone else’s, in the 40% tax, but their other assets are continuing to increase tax free. The consequence is that in ten years’ time or 20 years’ time the wealth gap in this country is actually going to be very much larger but with a relatively small number of people right at the peak of it, and that seems to be the inexorable result of the arithmetic. You have not had a chance to look at the arithmetic and I know you cannot comment on the system. I just throw that in as a thought. Can I ask you a completely different question. Offshore trusts are referred to as a problem area for all of you. How are you managing to deal with that?

Mr Gray: I think it was one of the questions that Mr Jenkins wanted to put to me. We have had a special scheme with a special investment to seek to address all these schemes. We are conscious that this is a difficult area where there was scope for us to improve our compliance—which is why we have dedicated specific resources under the spend-to-save scheme with the resulting figures that I gave to Mr Jenkins—

that we have generated over £11 million of additional compliance revenue with another £7.5 million in train.

Mr Williams: Richard wanted to ask a quick question and then I will give you several questions I would have asked but for you to take them away and let us have written answers on them. Richard?

Q98 Mr Allan: We have talked about Sharia mortgages and properties in the Report. I could not find an answer. Is there an answer? Have you got any definitive guidance on properties which have Sharia law mortgages on them? I think it is referred to in Box 18 on Page 29.

Mr Gray: Just a general answer we are not finding this as an area of difficulty at this stage.

Q99 Mr Allan: It is not a problem?

Mr Gray: But it is obviously something we are keeping an eye on.

Mr Leigh-Pemberton: We do get some questions on it, not very many which we deal with through the help line because there is not a standard arrangement so we need to know what the precise details are and then we give guidance over the telephone. That is the best way.

Q100 Mr Williams: Can I ask you to take away three questions to let us have written answers on. First of all, we have been told about some cases that have taken ten years to settle. Can you explain to us in detail why that is happening and whether there is likely to be a loss of tax as a result of the time involved. That is one. The second is why only 16 out of 1,000 chattel owners have relaxed their rules about viewing by appointment. What about the other 984, why are we not getting them to cooperate? And the final one is because of the delays you come across, referring to the ten years, why do you not use your power of direction more often to obtain information both from the representatives and from third parties like the banks and the insurance companies? So if you would not mind taking those away.

Mr Gray: I will be happy to let you have the answers.

Q101 Mr Williams: Thank you very much. Is this your first visit here?

Mr Gray: It is my first visit in this incarnation. In my previous departmental incarnation I had the pleasure of a couple of visits but it is my first one in this role.

Mr Williams: I cannot promise that it will always be as painless as this, but it has been very informative and I have found it very interesting. Thank you very much, gentlemen.

Supplementary memorandum submitted by the Inland Revenue

Q9 Mr Williams: *There is a big jump between 7% and being done for fraud. Rather than answering now you might be able to give us a figure or a graph showing what proportion of people pay what proportion of the maximum penalty?*

The Committee asked for a graph showing the amounts of the penalties levied.

The maximum penalty is 100% of the additional tax and that is abated to take into account:

- the circumstances in which the omissions came to light;
- the co-operation given to the IR in agreeing the additional tax; and
- the seriousness of the offence.

The graph attached shows the amount of penalties imposed for 2003–04 for each case.

NAO carried out a sample check of these cases and were satisfied that IR guidance had been followed.

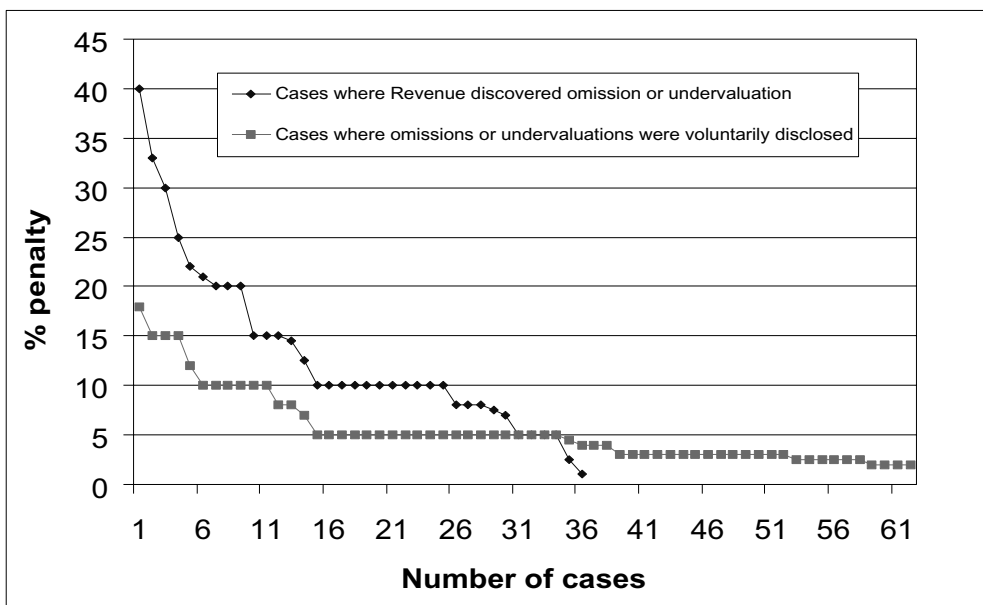
The role of penalties is to encourage people to meet their legal obligations as well as deter and penalise non compliance. The same approach is adopted for IHT as for other IR Taxes. We try and encourage taxpayers to get things right in the first place.

A distinctive feature of IHT is that it is the personal representative who completes the IHT account and in doing so, they often have to piece together the affairs of the deceased. Professional representatives may have had no knowledge of the deceased and are therefore dependent on the knowledge, honesty and integrity of the family and beneficiaries. Because of this, representatives may become aware of further assets after they have submitted the IHT return. The IHT penalty policy deliberately gives incentives for the voluntary disclosure of these omissions of which the Revenue might otherwise not be aware.

That policy also encourages active co-operation with enquiries to establish the correct liability. The level of penalties reflect these incentives.

Penalties are also tax geared so a penalty of 12% (the average—NAO report 2.16) applied to additional tax of £10,000 is £1,200. This is a material sum.

IHT penalty cases 2003–04



Q100 Mr Williams: Can I ask you to take away three questions to let us have written answers on. First of all, we have been told about some cases that have taken 10 years to settle. Can you explain to us in detail why that is happening and whether there is likely to be a loss of tax as a result of the time involved. The second is why only 16 out of 1,000 chattel owners have relaxed their rules about viewing by appointment. What about the other 984, why are we not getting them to co-operate? And the final one is because of the delays you come across, referring to the 10 years, why do not you use your power of direction more often to obtain information both from the representatives and from third parties like the banks and the insurance companies?

Q Why have some cases taken ten years to settle and is there likely to be a loss of tax as a result of the time involved?

A The oldest cases are the most complex of the IHT caseload. These are not cases where the IR is waiting for information or delaying. The cases have a third party involvement—litigation, Lands tribunal, Special Commissioners.

It is quite common where litigation to counter an avoidance device is under way in one case, for a number of similar cases to be held up until the point has been settled. Where appeals to the higher courts are involved, this process can take many years, and so all the cases remain open in the meantime.

In other cases, the parties are litigating among themselves—disputes between beneficiaries for instance.

As an example of how long it can take to settle cases, the recent prosecution case took more than five years to get to court and secure the prosecution. The case was being actively pursued throughout all that time—Lamberton received seven years for IHT fraud and embezzlement.

There is a balance to be struck between speed of settlement and the amount of tax at stake. In these cases, there is often large amounts of tax at risk and to settle prematurely in order to clear the cases might often mean forgoing the tax in dispute.

The risk of losing tax as a result is less. Tax is paid on an ongoing basis and only the disputed tax is unpaid. Even then payments on account may be made in order to reduce the interest charge when the matter is settled and the tax become due.

The assets involved are often land and it is difficult to conceal or move those away from IR reach.

These cases are a small percentage of IHT caseload—70% of accounts are now settled within six months and 90% are settled within 12 months. And we have reduced the number of 10 year old cases from 200 in 1999 to 80.

Q Referring to the ten year delay, why doesn't the Department use its power of direction more often to obtain information both from the representatives and from third parties like the banks and the insurance companies?

A The cases involved are not over 10 years old because of delay. They are the most complex cases often involving litigation or a third party involvement—see previous answer.

On the general point on powers of direction. The fact that the IR have the powers is a positive stimulant to compliance. Before taking formal proceedings, we give warning that we will do so and that itself produces positive results in most cases. In recent feedback, solicitors have acknowledged that they push their clients for information more quickly because they do not want to be the recipient of a notice.

The NAO note (paragraph 2.13 of their Report) that we have issued 67 notices to representatives and eight to third parties. Those figures are to March 2004 and since then we have issued a further five notices to representatives and two to third parties.

We regularly review our processes and make changes to ensure that they are fully effective. Powers of Direction are part of those processes.

Q Why have only 16 out of 1,000 chattel owners relaxed their rules about viewing by appointment. What about the other 984, why are we not getting them to co-operate?

A We have been concentrating on securing wider public access to the best quality objects. The change in agreements with 16 owners means the public now has better access arrangements to 1,900 objects that were previously “by appointment”.

We are continuing to review pre 1998 cases and, consistent with emerging case law, we will press for open access where, taking into account the appeal of the items and the owner's personal circumstances, it is justified.

FA 1998 gave the IR the authority to propose alternative arrangements taking into account the level of interest in the chattel and the circumstances of the owner into account. Before the change, FA 1998 gave exemption to chattels that were of a lower standard. Many of the items exempted under the old criteria do not have any broader public appeal; museums and galleries are not interested. In addition, the personal circumstances of the owners are such that changing the existing arrangements would not be just and reasonable.

It was always accepted that because of the lower quality test for chattels in FA 1998, it was likely that not all of the pre 1998 agreements would be changed. These chattels will not be eligible for conditional exemption when they are passed on to the next generation.

Other owners have resisted the 1998 legislation. Many were waiting for the outcome of the Special Commissioners case referred to at 4.6 in the NAO Report. That decision found squarely for the Revenue on the issue of principle. FA 1998 reforms do allow existing undertakings to be reopened; Revenue are entitled to review existing cases and to seek open access when we think that is appropriate.

The Special Commissioners decision will help us make improved proposals in future. The Special Commissioner paid tribute to the sensitivity and patience shown in formulating the IR revised access proposals.

18 January 2005