CHAPTER 10

"FALL IN VALUE" RELIEF

10.1 Increases in value

Assume a taxpayer gives away an asset (e.g. a house) and he makes a potential exempt transfer of £100,000. The house **increases in value** between the date of the gift and the date of the donor's death. When the donor dies the house is worth £500,000. Assuming the donor died within 7 years of the gift, the PET becomes chargeable and the donee is responsible for paying the inheritance tax.

The amount on which the donee is charged to IHT is the **original PET of £100,000**. There is **no concept of revaluing a PET at the date of death**. The effect of the transfer has been to "freeze" the value of the PET for Inheritance Tax purposes.

This is very sensible tax planning. By giving away an asset which is likely to increase in value, the donor has made sure that the subsequent increase in value has been removed from his death estate. If the donor had retained the asset until the date of his death, the value at death – i.e. £500,000 – would have been charged to inheritance tax in his death estate. Therefore as part of an overall estate planning exercise, if a donor wishes to make lifetime gifts it is sensible to give away assets which are likely to increase in value.

10.2 Falls in Value

Now consider what happens when an asset goes **down in value** between the date of gift and the date of the donor's death. Assume that a donor gives away a building when it is worth £500,000. The asset falls in value such that on the death of the donor the building is worth only £100,000. Under general principles, there is no concept of revaluing a PET at the date of death, so the amount to be charged on the donee is the original PET of £500,000.

This leaves the donee with a problem. He could potentially be paying inheritance tax at 40% on the PET, whereas in reality he only has an asset which is worth £100,000. Therefore he could be left with an asset which is worth less than the inheritance tax due. To alleviate this problem, the taxpayer may make a "fall in value" claim under S.131 IHTA 1984.

A fall in value claim is made by the **donee to reduce the death tax on a lifetime gift**. Fall in value relief claims can be made to reduce death tax on a potentially exempt transfer. A similar claim could be made by the trustees to reduce any additional tax payable on chargeable lifetime transfers within 7 years of death.

IHTA 1984, s. 131

The amount of the fall of value relief is the **difference between the value of the asset at the date of the original gift and the value of the asset at the date of death**. This fall in value **reduces** the amount which is charged to IHT on the death of the donor.

IHTA 1984, s. 131(2)

It is possible for the donee to make a fall in value claim even if he **no longer owns** the asset at the date of the donor's death. Unlike BPR, there is no requirement for the donee to retain the asset in order to claim fall in value relief.

If the donee has **sold** the asset before the donor dies, the amount of the fall in value relief is the **difference between the value of the asset at the date of the gift and the gross sale proceeds**. This difference is again deducted from the amount charged to IHT at the date of the donor's death.

Illustration 1

Peter owns a building. In December 2006 Peter gave the building to Paul. The building was worth £100,000 at the date of the transfer and after deducting annual exemptions Peter has made a PET of £94,000. Peter died in May 2010, when the building is worth £75,000. The building has gone down in value between the date of gift and the date of death.

Paul has tax to pay on a PET of £94,000. However as the value of Paul's asset at the date of death is **lower** than it was at the date of gift, Paul can make a fall in value relief claim. The amount of the fall in value is the difference between £100,000 and £75,000. The building has gone down in value by £25,000, so this is Paul's fall in value claim.

	£
PET	94,000
Less: Fall in value (s. 131)	
£(100,000 – 75,000)	(25,000)
Chargeable on death	69,000

The amount chargeable to inheritance tax on the death of Peter is £69,000. Paul will pay inheritance tax on this in the normal way.

It is important to note that **for cumulation purposes the original PET of £94,000 remains on the donor's "clock"**. Therefore a fall in value claim will affect the amount chargeable on Paul, but does not have any impact as far as the donor's brought forward total is concerned.

10.3 Interaction with "loss to donor" principle

When considering Section 131, we must be careful about the interaction between "**fall in value relief**" and the "**loss to donor**" principle. We measure the "value transferred" for IHT purposes in terms of the "**loss to donor**" principle and by using **related property** rules. This will give us the value of the PET or CLT.

IHTA 1984, s.3

However, we measure fall in value relief by looking at the loss to the donee - i.e. the **difference between the value of the asset in the hands of the donee at the date of gift and either the value at death or the gross sale proceeds**. Therefore we use the "loss to donor" to measure the value transferred, but consider the "loss to donee" when thinking about fall in value relief.

Illustration 2

Anthony owns 75% of the shares (7,500 shares) of Investco Ltd, an unlisted investment company. Anthony's wife Jane owns the remaining 25%. Anthony gives 2,000 shares to his friend John in 2008, thereby making a PET for IHT purposes. The market values of the shares at the date of the gift is as below:

Market values:	£
100%	160,000
80%	100,000
75%	90,000
55%	60,000
20%	10,000

The first thing we need to do is to identify the value transferred by Anthony. We therefore consider the loss to donor and related property rules.

Before the transfer Anthony owned 75% and his wife owned 25%, so the related property is 100% of the shares, collectively valued together at £160,000. Anthony is therefore deemed to have had $\frac{75}{100}$ **ths of the value of a 100% holding**.

After the transfer Anthony has 55%. Jane still has 25% so the related property is an 80% holding worth £100,000. Therefore Anthony has $\frac{55}{80}$ **ths of the value of an 80% holding.**

	£
Before gift: $\frac{75}{100}$ x £160,000	120,000
After gift: $\frac{55}{80}$ x £100,000	(68,750)
Value transferred	51,250
Less AEs x 2	(6,000)
PET	45,250

This will bear no resemblance to what the donee (John) has gained as a result of the gift (i.e. a 20% holding worth £10,000). Under basic principles of inheritance tax we measure the value transferred in terms of the **loss to the donor** rather than the gain to the donee.

John sells his shares for £8,000.

Anthony died in January 2011. The **PET of £45,250 now becomes chargeable on John**.

John will consider a fall in value claim. To do this he will look at the **value of his 20% holding at the date of the gift**. At the date of the gift, a 20% holding valued on its own was worth £10,000. John sold the shares prior to Anthony's death so we compare this with the **gross proceeds of sale** which were £8,000. John's fall in value is therefore **£2,000**. This can be deducted from the PET.

	£	£
PET now chargeable		45,250
Less: fall in value relief		
MV @ gift (20%)	10,000	
less sale proceeds	(8,000)	
= S. 131 relief		(2,000)
Amount chargeable on John		43,250

The amount chargeable to inheritance tax on John will therefore be £43,250. From this we deduct any remaining nil band and calculate tax in the normal way.

Note in this example we have measured the PET in the terms of the loss to donor. However, when considering a fall in value claim, **we look at the donee's asset in isolation** and measure the fall in value of that asset on a "stand alone" basis.

Also note that the **original PET of £45,250 remains on the donor's "clock" for cumulation purposes**.

10.4 Business and agricultural property

IHTA 1984, s. 131(2A)

Where business or agricultural property is given away and it falls in value between the date of gift and the date of death, there is an inter-action between BPR/APR and Section 131. **If the original transfer qualified for BPR or APR, then any fall in value relief is reduced by the same percentage**. Fall in value relief comes into the computation **after** any APR or BPR. This is important as far as the donor's cumulative total is concerned.

Illustration 3

Assume a taxpayer owns a building personally and that building is used by a partnership of which he is a member. In May 2007, the taxpayer gave the building to his son when it was worth £800,000. This is a PET which might qualify for BPR depending on what the son does with the building.

Transfers of land and buildings owned by an individual and used by his partnership qualify for BPR at 50%. However, there is no point allocating the BPR against the PET. We simply consider the availability of BPR if the donor dies within 7 years.

In March 2008, the taxpayer made a cash gift to a discretionary trust. The chargeable lifetime transfer (after exemptions) is £100,000. As this is the first chargeable lifetime transfer, a full nil band is available for 2007/08. The nil band will **wipe out** the transfer leaving **no inheritance tax payable**.

The donor died in January 2011. At that date, the building given to the son was worth 600,000.

We will carry out 2 inheritance tax calculations. The first will be on the **PET to the son in May 2007**. As the gift was of business property we need to consider the availability of **BPR** to reduce the transfer on death. You will also note that the building has **fallen in value between the date of gift and the date of death** so the son will make a Section 131 claim.

The second inheritance tax calculation will be on the **chargeable lifetime transfer in March 2008**.

(i) PET (May 2007)

The value of the building in May 2007 was £600,000. Assuming the son has retained the building at the death of the donor, BPR will be available. As the building was owned by the donor and used by his partnership, BPR is given at a rate of 50%.

PET (May 2007):	£
Value transferred	800,000
Less: BPR @ 50%	(400,000)
	400,000
Less AEs x 2	(6,000)
	394,000

The son will make a fall in value claim. The building was worth £800,000 at the date of gift and £600,000 at the date of death so the fall in value is £200,000. However, as the original transfer qualified for 50% BPR, we must similarly **reduce the fall in value claim by 50%**. Fall in value relief is therefore £100,000.

	£
Chargeable transfer	394,000
Less fall in value relief	
£(800,000 – 600,000) x 50%	(100,000)
Chargeable on donee	294,000
Nil band 2010/11 (full)	(325,000)
Taxable	Nil
IHT payable by son (no taper relief)	Nil

When PETs become chargeable on the death of the donor, **for cumulation purposes we take the value of the PET after any BPR has been given**.

However, when a donee has made a **fall in value** claim, this **does not affect the brought forward total for cumulation purposes**. Therefore the amount which goes into the donor's 7 year total for IHT purposes is **£394,000**. This is why it is important to take any APR or BPR before any fall in value relief.

(ii) CLT (March 2008)

	£	£
Gift (no AEs available)		100,000
Nil band 2010/11	325,000	
Less: CTs in 7 years before gift	(394,000)	
Remaining		Nil
Taxable		100,000
IHT @ 40%		40,000

In summary, where a PET becomes chargeable on death, the cumulative total is effected by business or agricultural property relief and annual exemptions, but is unaffected by any fall in value claims.

10.5 Miscellaneous points

No fall in value claim can be made if the property gifted is a "wasting chattel". A wasting chattel is tangible, moveable property with a useful life not exceeding 50 years. HMRC will not give fall in value relief on an asset which is almost certain to fall in value anyway.

IHTA 1984, s. 132

No fall in value relief claims can be made by a donee if the property originally transferred to him was **cash**.

For example, assume a donor gives cash to a donee. The donee uses the cash to buy a house. The house subsequently falls in value. The donor dies within 7 years such that the original PET becomes chargeable. It is not possible for the donee to make a Section 131 claim in respect of the fall in value of the house because the **original asset gifted to the donee was the cash**. The fact that the donee used the cash to buy an asset which has subsequently fallen in value is irrelevant.

Example 1

Eleanor owned 55% of the shares in an unlisted investment company.

In May 2007 she gave a 20% holding to a discretionary trust. Eleanor paid the IHT due. The value of the shares was as follows:

	£
55% holding	640,000
35% holding	200,000
20% holding	100,000

The trustees sold the shares in 2008 for £75,000. Eleanor died in June 2010.

Calculate the IHT payable on death.

Answer 1

(i) Lifetime tax (May 2007);

	£
Value of shares before gift	640,000
Value of shares after gift	(200,000)
Value transferred	440,000
Less: AEs x 2	(6,000)
Chargeable lifetime transfer	434,000
Nil band 2007/08	(300,000)
Taxable	134,000
IHT @ $\frac{20}{80}$	33,500
Add: CLT	434,000
Gross chargeable transfer	467,500

(ii) Death tax (June 2010):

	£
Gross chargeable transfer	467,500
Less: fall in value relief	
£(100,000 – 75,000)	(25,000)
Chargeable on death	442,500
Nil band at death	(325,000)
Taxable	117,500
IHT @ 40%	47,000
Less: taper relief (3-4 yrs = 20%)	(9,400)
Less: lifetime tax	(33,500)
Tax due on death	4,100