# CHAPTER 12

# IHT VALUATION RULES

## 12.1 Special valuation rules

IHTA 1984, s.160

The general rule for valuing an individual's assets at the date of the death is to take the **open market value** of each asset – i.e. the price which each asset might reasonably be expected to fetch if sold in the open market at the date of death

There are special rules for valuing certain types of assets, such as **quoted shares or units in authorised unit trusts**. We shall also look at the rules for valuing **jointly owned assets**. These could be assets owned jointly by a husband and wife (in which case we will revisit the "related property" rules), or they could be assets held jointly by individuals who are not spouses.

We shall also look at the valuation rules for **life assurance policies** and for assets situated **outside the UK**.

## 12.2 Quoted shares and unit trusts

TCGA 1992, s.272(3)

The way to value quoted shares or authorised unit trusts is straight-forward. To value quoted shares we look at the **official list published by the Stock Exchange** at the date of death. The official list of share prices is published on a daily basis in financial journals such as the Financial Times.

If an individual dies on a non business day – i.e. on a day when the Stock Exchange is closed – there are two alternatives. To value quoted shares, we may **either use the prices for the preceding business day or the next following business day**. The same day's prices should be used to value all shares in the portfolio – we cannot chop and change between different day's prices as it suits us.

The only minor complication is that the Stock Exchange official list does not simply give **one** price for quoted shares. The official list will give the closing "bid" prices and closing "offer" prices of all quoted shares and securities. What is quoted in the Financial Times is the "**bid to offer spread**".

The "bid" price of a share is the price at which the broker will buy from the customer. The "offer" price of a share is the price at which the broker will sell to the customer. The difference in prices is the way in which the broker will make his profit.

When faced with 2 prices, which one do we use to value the shares for IHT purposes? We will prepare **2 computations** and take whichever produces the **lowest figure.**

First we value quoted shares using the "**quarter up**" rule.

**Illustration 1 – "quarter up"**

Assume that a taxpayer dies owning shares in a quoted company called OTL Plc. At the date of death, OTL Plc shares are quoted at 150p to 158p. The spread of prices is 8p. Under the "quarter up" rule, we take a quarter of the spread, i.e. 2p.

We add this to the **lower** of the 2 figures (the "bid" price), to give a "quarter-up" price of 152p. Essentially we have taken a point which is one-quarter distance between the bid and offer prices.

**Illustration 2 – "average of bargains"**

The alternative calculation is to take the **average of the highest and lowest marked bargains on the relevant day**. A "marked bargain" is a price at which the relevant shares were traded on that particular day, ignoring any transactions at special prices. To take the average of the highest and lowest daily bargains, we simply add the lowest figure and the highest figure and divide the result by 2. Any prices in between can be ignored.

Assume that at the date of the taxpayer's death, the shares in OTL Plc have been traded at 148p, 151p and 158p. We are interested in the highest and the lowest prices, ignoring all prices in between. If we add the highest and lowest bargains and divide by 2, the average is 153p.

For IHT valuation purposes, we take the **lower of the price using the "quarter up" rule and the price using the "average bargain" rule**. Here this is the quarter up price of 152p.

Therefore for IHT purposes, each of the taxpayer's shares in OTL Plc is deemed to have been worth 152p at the date of death. These valuation rules for quoted shares apply in the same way for Capital Gains Tax.

An adjustment to the share price is required if the prices are quoted "ex-dividend" at the date of death. All quoted shares will have an "ex-dividend" date. The ex-dividend date is the cut off point as far as an entitlement to a dividend is concerned. If a shareholder owns shares in a company at the ex-dividend date, he or she will be **entitled to the next dividend paid** by the company.

**Illustration 3**

Chris owns shares in OTL Plc. The ex-dividend date for the OTL Plc shares is 15 May. This means that all shareholders who own shares in OTL Plc at 15 May will be entitled to the dividend that OTL Plc pay out a few weeks later on 12 June.

Typically there are a few weeks between the ex-dividend date and the date that the dividend is actually paid. Therefore if Chris **sells** his shares in between the

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ex-dividend date and the payment date, he will **still be entitled to the dividend** that is paid on 12 June.

The fact that shares may be "ex-dividend" at the date of death, will have an impact on the inheritance tax calculation.

Assume Chris owns 10,000 shares in OTL Plc. The OTL shares go "ex-dividend" on 15 May. A dividend of 10p per share is physically paid by OTL Plc to its shareholders on 12 June. Therefore a taxpayer owning 10,000 shares will receive a net dividend of £1,000.

Chris dies between the ex-dividend date of 15 May and the payment date on 12 June.

At the date of his death, Chris was **actually entitled to the dividend** that will be paid on 12 June. As Chris is no longer alive, the company will instead pay the net dividend of £1,000 to Chris's Executors. Therefore when valuing Chris's death estate, we treat this £1,000 as an **asset of the estate for inheritance tax purposes**. When valuing Chris' OTL Plc shares for inheritance tax purposes, we **increase the share value by the net dividend of £1,000**.

Note that for income tax purposes, the £1,000 dividend is **not** treated as Chris's income, and will **not** be entered on Chris's tax return to the date of death. Dividends are taxable when they are **received**. The £1,000 dividend is therefore treated as the income of the Executors.

The "quarter up" rule only applies for **quoted shares - it does not apply for unit trusts**. We simply value unit trusts by taking the **lower of the bid and offer prices quoted**. This is the "bid" price - i.e. the price at which the investor could sell the units to the broker.

TCGA 1992, s.272(5)

If the taxpayer dies on a non business day, we always use unit trust prices for the **last preceding business day**. Unlike quoted shares, we have no choice.

## 12.3 Unquoted shares

The problem with valuing unlisted shares and securities is that there are no published prices because there is no "open market" for the shares. Shares in private companies are not openly tradable so it can be difficult to arrive at a fair market value. An agreement must therefore be reached between the taxpayer and HMRC as to what a **hypothetical market value** of the unlisted shares will be.

TCGA 1992, s.273

IHTA 1984, s.168

There will often be a drawn out process of negotiation between shares valuation experts acting both for the taxpayer and HMRC. It is sufficient at this point to note that factors such as the **net assets** of the company, or **dividend yields**, will be taken into account in trying to arrive at a true and fair value of the shares.

Valuations of shares in unlisted companies will be referred by the local tax office to HMRC's Specialist Shares Valuation Division for consideration. For examination purposes, the value of the unquoted shares and securities will be given to you in the relevant questions.

Remember, if an individual owns shares in an **unquoted trading company**, the value of the shares is likely to be entirely covered by **100% business property relief**. If this is the case, the actual value of the shares is largely irrelevant, and for this reason the HMRC Inheritance Tax may be reluctant to enter into a formal valuation exercise.

## 12.4 Accrued income

Accrued income is income which is **due to the deceased at the date of death, but had not been physically received prior to death**.

This may happen where;

(i) a dividend on company shares has been declared and is due for payment in the deceased's lifetime, but the cheque has not been issued prior to the death;

(ii) interest has become payable on a security (eg, a government gilt) by the date of death but the deceased had not been credited with the interest before his death; or

(iii) interest has been earned on a bank account, but the account-holder died before the interest was actually credited to the account.

In all the above cases, **the accrued income belongs to the deceased and should be included as an asset of the death estate for IHT purposes**.

Do however note that for income tax purposes, interest and dividends are taxable on a "receipts" basis. Therefore the income which is accrued but not received would **not be included on the deceased's self-assessment return to the date of death.** Instead it would be reflected in the first income tax return filed by the Executors in the administration period.

## 12.5 Jointly owned assets

If assets are owned jointly between a **husband and a wife** (or between civil partners), when valuing the asset for IHT purposes, we must have regard to the "related property" rules. Assets held by a charity as a result of a gift either from the donor or the donor's spouse or civil partner are also related property for IHT purposes.

IHTA 1984, s.161

Only assets jointly held with one's **spouse** / civil partner are "related". If assets are held jointly with a non-spouse (brother, sister, boyfriend, girlfriend) – the related property rules do **not** apply.

When applying the related property rules, we value a taxpayer's assets by taking **a proportion of the aggregated value of the jointly held property**.

**Illustration 4**

Assume a husband and a wife own shares in the same company. The husband owns 40% of the shares and the wife owns 20% of the shares. If the husband dies, we need to ascertain the IHT value of his 40% holding. To do this, **we do not look at his 40% holding in isolation**. Instead the husband is deemed to have **40/60ths of the value of a 60% holding**.

In practice, the related property provisions will be most commonly applied to unquoted shares, but they can be equally relevant for jointly held land and buildings.

**Illustration 5**

Assume a building is worth £400,000. This building is owned jointly by a husband and a wife. On the death of the husband, the value of **half** of the building will fall into his death estate. We therefore need to consider how to value the husband's half of the building at on his death.

Because a husband and wife jointly own an asset, we need to have regard to the related property rules. Therefore **we do not simply look at the husband's half of the house in isolation**. Instead we assume that the husband has **50% of the whole of the asset**, which means that his portion is worth £200,000 for IHT purposes. We have simply taken an appropriate proportion of the aggregated value of the husband and wife's joint asset.

However, we need to apply a **different set of rules when an asset is held jointly by individuals who are not married to each other**.

Assume that a house worth £400,000 is jointly owned by a brother and a sister. On the death of the brother, we need to value his **half share** in the house for IHT purposes.

The related property provisions do not apply to assets held jointly by brothers and sisters, so instead we must **value the brother's half share in the house on a "stand alone" basis**. The amount to be charged in the brother's death estate, is simply the **open market value** of his share in the property. Remember that open market value means the price that this asset (i.e., half a house) could **reasonably be expected to fetch if sold on the open market**.

HMRC accept that the brother's half of the property is not necessarily worth 50% of the whole property if sold on the open market. The brother would not have been able to sell his share in the house for £200,000, because the remainder of the property is owned by another tenant.

For inheritance tax purposes, HMRC accepts that in these circumstances a "**tenanted deduction" of between 5% and 15% is appropriate**. Therefore when valuing the brother's half of the property for IHT purposes, we can **reduce the value of £200,000 by between 5% and 15%.** In practice this will be subject to negotiation with HMRC. For examination purposes, a tenanted deduction of 10% is an acceptable approach.

## 12.7 Co-ownership of land under English Law

If property is owned jointly by 2 or more persons, these persons will either hold the land as "joint tenants" or as "tenants in common".

*(i) Joint tenants*

If property is held as joint tenants, on the **death of one of the joint tenants the property automatically reverts to his or her fellow joint tenant**. This is the legal form under which a husband and wife will typically own the marital home. Therefore on the death of one of the spouses, his or her share in the property will automatically pass to the other spouse by survivorship. Holding a property as joint tenants also means that if one of the co-owners wishes to sell all or part of his or her share in the property, both of the tenants must consent to the sale.

*(ii) Tenants-in-common*

If property is owned by individuals as "tenants in common", **on the death of one of the co-owners, his or her share of the property will pass either under the terms of the Will or under the rules of intestacy**. Under a "tenants in common" arrangement, the property does **not** automatically revert by survivorship to the fellow tenant in common.

This type of ownership permits the individual owners to sell their share in the property to whoever they want to, **without the need to obtain agreement from a fellow tenant in common**.

When acquiring joint property, the co-owners can decide which type of joint ownership they wish to create. The co-owners can later change their mind and either severe a joint tenancy or convert a tenancy in common to a joint tenancy.

For IHT purposes, the legal form under which individuals own property **does not affect the way we value the property**. Joint property is either valued under the **related property** rules if it is jointly held by spouses, or it is valued giving a **tenanted deduction** if it is jointly owned by non spouses.

The distinction between whether the property is held as joint tenants or tenants in common is important because it tells us the **destination of the asset** for IHT purposes.

For example, if individuals own a property as joint tenants, on the death of one of the owners the property will **automatically revert to the fellow joint tenant**. If, for example, the fellow joint tenant is a **spouse,** this is an **exempt transfer** for IHT purposes. If the fellow joint tenant is **not a spouse**, the transfer will be **chargeable** to inheritance tax in the normal way.

## 12.7 Life insurance policies

First we will define a couple of basic terms.

(i) *"Life assured".*

The "life assured" is the **person on whose life the insurance policy is taken out**. The insurance company will only make a payment on the death of the life assured.

*(ii) "Beneficiary"*

When the "life assured" dies, the **person to whom the policy proceeds are paid** is called the "beneficiary".

The "life assured" and the "beneficiary" could be the same person or they could be different persons.

We need to consider how the policy proceeds are dealt with on the death of either the life assured or the beneficiary.

**Scenario 1**

Let us take a life assurance policy under which Mr A is the life assured. Mr A is also the beneficiary of the policy.

This means on the death of Mr A, the **policy proceeds will be paid into Mr A's death estate**. If this is the case, the maturity proceeds of the policy will form part of Mr A's death estate for IHT purposes and will be charged to tax. It is therefore more common for the life assured and the beneficiary to be different persons.

IHTA 1984, s.171

**Scenario 2**

Assume instead that we have an insurance policy under which Mr A is the life assured, and Miss B is the beneficiary. This means that **on the death of Mr A, the maturity proceeds of the policy would be paid to Miss B**.

As far as Mr A's death estate is concerned, as the maturity proceeds will not be paid to Mr A's Executors, **no part of these proceeds are brought in to Mr A's death estate**.

**Scenario 3**

Finally, consider a policy under which Mr A is the life assured and Miss B is the beneficiary. Again the insurance company will pay out to Miss B on the death of Mr A.

If **Miss B dies before Mr A**, the insurance company will **not pay out any proceeds** because the life assured (i.e. Mr A) is still alive.

However, Miss B's Executors **do own an asset** at the date of her death, that asset being the **right to receive the insurance proceeds when Mr A dies**. For IHT purposes, the **open market value** of the policy – i.e. the amount the policy could be sold for on the open market – is treated as an **asset of Miss B's death** estate.

Note it is the **open market value of the policy which is charged to inheritance tax**. This is not necessarily the same as the surrender value.

If a **policy** is **assigned** during a person's life, the value of the transfer is the **higher** of the **open market value** of the policy **and** the **premiums paid to date**. The surrender value is ignored.

## 12.7 Foreign assets

If an individual dies domiciled in the UK, his worldwide estate is chargeable to inheritance tax. The location of the asset is irrelevant.

However, if an individual dies and he or she is not domiciled in the UK, **inheritance tax is only charged on assets which are situated within the UK**. Non UK assets owned by a non domiciliary are "excluded property" for IHT purposes and are not brought in to the IHT computation.

IHTA 1984, s.6(1)

If foreign property is chargeable to UK inheritance tax and the value of that foreign property is quoted in a foreign currency, it must be converted into sterling before IHT can be calculated. For conversion purposes, we use the "London Buying rate" which is designed to give the lowest sterling valuation.

Finally when considering foreign assets, remember that any **additional costs of administering a foreign estate** (e.g., costs of obtaining probate over overseas assets etc) can be deducted in the IHT computation up to **a maximum of 5% of the value of the foreign assets**.

IHTA 1984, s.173

### Example 1

Jasmine died on 19 March. She had 50,000 shares in Allen plc quoted at 175-181 at the date of death. There were marked bargains at 173, 176, 177 and 181 on 19 March.

The ex-dividend date was 12 March. A dividend of 5p per share was paid on 31 March.

**Calculate the value of the Allen plc shares in Jasmine's estate at the date of death.**

### Example 2

Steve owns a property jointly with his girlfriend Lynn. They hold the property as joint tenants. Steve died in December 2010 when the house was worth £500,000. Steve's only other asset was 100,000 units in the ABC Growth Trust quoted at 115-119 at the date of death. Steve made no lifetime gifts and left his entire estate to Lynn.

**Calculate the IHT payable as a result of Steve's death.**

**Answer 1**

Lower of

(i) "¼ - up"
175p + ¼(181 – 175)= 176½p

(ii) Average of high/low bargains
= ½(173 + 181) = 177p

| | £ |
|---|---|
| Value = 50,000 shares x 176½p | 88,250 |
| Add: net dividend paid 31 March: 50,000 shares x 5p | 2,500 |
| Value included in Estate | £90,750 |

**Answer 2**

| | £ | £ |
|---|---|---|
| House - ½ share | 250,000 | |
| Less: tenanted deduction (assume 10%) | (25,000) | |
| IHT value | | 225,000 |
| Unit trust: 100,000 units @ 115p | | 115,000 |
| Chargeable estate | | 340,000 |
| Less: nil band (fully available) | | (325,000) |
| Taxable | | 15,000 |
| IHT @ 40% | | £6,000 |