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THE ONLINE MONTHLY FOR THE ALTERNATIVE INVESTMENT MARKET

A storm in a teacup – would abolition of IHT really hit AIM?

Ahead of the upcoming Autumn Statement (November 22nd, 2023) there has been much speculation that the government could use this as an opportunity to cancel inheritance tax, something which is often derided both in terms of the scale in which it is levied and who ends up footing the bill. A 2023 YouGov poll found that only 20% of respondents deemed it ‘fair’. Whilst such taxes aren’t uncommon globally, their application ends up resulting in widely differing outcomes and ultimately despite growing wealth inequality, there’s perennial push back against taxation of wealth as opposed to income. The tax raises around £7bn annually, in the backdrop of Tax Receipts of 786bn in £2022/23.

The headlines have laid the problem out in no uncertain terms, suggesting that wholesale abolition of IHT would lead to a fire sale of AIM stocks, on the premise that these are being held largely as a way of circumventing the tax. But is that really an issue, or is it another play to depress growth stock valuations – which have already suffered badly over the last couple of years – even further?

A report by AJ Bell [1]which was published earlier in the year concluded that given the lacklustre historical returns posted by the junior market as a whole compared to many other benchmarks, investors who have been holding positions for a decade or more would be better off investing in a global fund and taking the IHT hit, rather than buying AIM Shares.

And whilst it’s important to remember there are plenty of AIM success stories out there – again AJ Bell highlight the 1,570% uptick in AB Dynamics over the last decade, the 1,330% gain for YouGov and a 322% rally for Jet2 – these are the exceptions rather than the rules. A further complication is that not all AIM stocks are eligible for the IHT exemption – those deemed to deal mainly in shares or property fall outside of the scope, but there’s no definitive list.

In short, it’s very easy to discredit the “AIM as an IHT hedge” line. It’s arguably a nice bonus for founders and directors, but rationally in the majority of instances it doesn’t in its own right present a meaningful investment rationale. And because the tax exemption doesn’t apply to collective holdings such as funds, again the risk of an exodus needs to be put in perspective.

[1] https://www.investments.lloydsbank.com/get-inspired/news/article/13387552

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A storm in a teacup – would abolition of IHT really hit AIM? (cont'...)

Would a better solution be to abolish IHT on any UK equity holdings?

Amidst a backdrop of calls for greater investment into the UK equity market by retail investors, such an approach seems worthy of closer inspection. Indeed data from M&G compiled for The Mail on Sunday estimated that by extending the IHT exemption to cover all main market stocks would take just 1.4% [1]off the annual tax receipts. It would also align far better with the current government narrative of channelling more funds into the UK equity markets and maintain the bulk of this taxation stream, whilst simultaneously mitigating the threat of a fire sale of AIM stocks should IHT be eradicated on a wholesale basis.

Changes to Inheritance Tax regulations do however come with a potential hidden burden, namely the impact of capital gains tax. The current IHT protocols serve to re-value the shares on the date of probate, but without this measure, would beneficiaries be liable to CGT on the entire appreciation of the holding when they ultimately sell? With the Capital Gains Tax allowance falling to just £3,000 in April 2024, does this approach actually pass an even greater burden onto those with smaller estates? Assets which would have previously been free of any IHT burden are now attracting Capital Gains Tax.

There’s plenty of evidence that already shows the imbalances in the application of IHT. Indeed a report by the Office of Tax Simplification showed that the effective rate for very large estates – those worth over £7m – was just 10%, around half the rate paid by estates worth between £2m and £3m, as a result of the financial engineering that can be done cost effectively when so much capital is at stake.

With that in mind, it’s difficult to see how any wholesale change to the current situation could prove beneficial to society. How Chancellor Jeremy Hunt cares to treat this at the end of the month, however, will be keenly watched by observers from all sides.

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