INHERITANCE TAX

Agricultural and Business Property Reliefs - latest developments
“the accountants view”

HILARY SHARPE / JACQUELINE THOMSON
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BUSINESS PROPERTY RELIEF

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BUSINESS PROPERTY RELIEF

Current landscape

• IHT back on the agenda
• Impact of next years election
• National Audit Office review April 2014
  • IHT tax take £3.1bn, BRP/APR costing £735m
• Hybrid nature of businesses
• Greater scope for HMRC challenge.
BUSINESS PROPERTY RELIEF
The basics

3 conditions to be met
2 limitations to take in to account

The conditions

• The business must not be **wholly** or **mainly**:
  - Dealing in securities, stock, shares, land or buildings
  - Making or holding investments

• The business asset must have held the asset for 2 years
  - Asset does not need to have been qualifying for 2 years
  - Aggregation on death
  - Rights issues (check the legals)

• Must be no binding contract for sale
  - Articles/ shareholder agreements/ share schemes.
BUSINESS PROPERTY RELIEF
The basics - continued

The limitations

• Excluded assets
  • Investment subsidiaries in trading groups
    Note:
    Disregard properties used by group members

• Excepted assets
  • Not wholly or mainly used for the purposes of the business for the 2 years before the transfer; or,
  • Was not required at the time of the transfer for future use of the business e.g. private assets or excess cash.
WHOLLY OR MAINLY?
All or nothing test

If 50% or more is in non investment activities BPR is available in full

X Ltd is a stand alone trading company. Generated surplus cash in recent years which it has used to buy a number of rental properties

- Value of properties 40% of total business - 100% relief
- Value of properties 60% of total business - 0% relief.
WHOLLY OR MAINLY HMRC continue to follow the decision in the Farmer case
This established that:

• No single factor should determine the nature of the business
• Look at business in the round over a period of time (to allow for temporary changes in activity, losses etc) giving consideration to:
  • Profit
  • Turnover
  • Capital employed (value of assets net of liabilities)
  • Time spent by directors and employees
  • The overall context of the business.

Be prepared to provide evidence
PROPERTY BUSINESSES
Impact of recent cases

Move towards investment assumption
Range of business - simple letting to hotels
Need to be able to demonstrate additional services are material

HMRC guidance:
- Hotels, B&B, residential homes - non investment
- Furnished holiday lets - investment
- Potential areas for review
  - Self service / budget hotels
  - Self storage
  - Car parks
  - Livery stables
  - Moorings/ beach huts.

Evidence will be essential if to show not incidental
WHOLLY OR MAINLY?

Groups

Cannot be wholly or mainly an investment business but holding companies can still qualify provided they are either:

- Wholly or mainly trading in their own right, or
- A holding company of “trading group” (has one or more subsidiaries who are wholly or mainly carrying on a trade)

Meaning of subsidiary - Companies Act definition

- Majority of voting rights, or
- A member with the right to appoint the majority of the board.

Don’t have to have large shareholding to be subsidiary
BUSINESS PROPERTY RELIEF
Groups - pure holding company

Example 1

Holdco

Trade Co (40%)
Trade Co (50%)
Invest Co (10%)

Example 2

Holdco

Trade Co (20%)
Trade Co (20%)
Invest Co (60%)
BUSINESS PROPERTY RELIEF
Groups - holding company with other activities

- Holdco neither wholly or mainly trading co or a holding company
- Consider planning but need time to implement

Trading 40%
Holding Company 40%
Investment 20%
EXCEPTED ASSETS
Restrict relief

• Excepted assets
  • Not wholly or mainly used for the purposes of the business for the 2 years before the transfer; or,
  • Was not required at the time of the transfer for future use of the business

• HMRC focus on
  • Shares and other investments not used in the business
  • Assets used for private use (house, yachts etc)
  • Surplus cash.
EXCEPTED ASSETS

Cash

• What amounts to surplus?
• HMRC will review if >25% turnover
• HMRC can be expected to look for clear evidence of how the funds are to be used
• HMRC questions:
  • Was the cash used in the business?
  • Was the cash used to finance the business being carried on?
  • How much cash did the business regularly use?
  • What were the short term cash requirements?
  • Does the amount of cash fluctuate?

• Cash buffer?
**EXCEPTED ASSETS**

**Cash - example**

- Trading company
- 51% shareholding (78% including related property)
- Turnover £10m, PBT £600k, Net assets £2m with £1.2m on 30 day deposit account
- HMRC questioned the cash
- Accepted that surplus amounted to £100k, restriction on BPR of £51k
- Demonstrated the need for records to be retained to evidence the use of cash if large cash balances are being retained
- Also highlighted the importance of the accounts - the accounts made separate disclosure of the deposits as investment assets - if they had been simply left as cash would HMRC have challenged?
EXCEPTED ASSETS

Friend or foe?

- The value of an excepted asset is its net value at the valuation date
  - If a company has borrowings charged on its assets make sure it is the excepted assets that are charged
- The restriction in BPR is based on the fall in the value of the asset
  - Value of the asset with the excepted asset and without the excepted asset
  - The fall in value will not be eligible for BPR.
EXCEPTED ASSETS
Friend or foe?

• Valuation can be critical when looking at company shares
• Basis of valuation can lead to unexpected results
• Majority shareholdings
  • based on the capitalised value of the business will suffer some restriction
  • Shareholder has 100% of shares valued at £5m and excepted asset £1m
  • Gives away 25% of shares but keeps control
    - value of gift £1.25m (£5m - £3.75m) but only BPR on £1m
    - restricted by 1/5th £250k
  • Gives away 51% of shares, now valuing a minority shareholding post gift
    - say value of 49% holding post gift with 40% discount £1.47m
    - value of gift £3.53m (£5m - £1.47m) but only BPR on £2.82m
    - restriction still 1/5th but £710k not £510k.
EXCEPTED ASSETS
Friend or foe?

• Minority shareholdings
  • HMRC accept that for minority shareholdings where valuing business on dividend yield or earnings basis that an excepted asset may make little difference particularly if 10% shareholding or less
  • Also accept for groups of companies if the value of an excluded subsidiary is small it can be left out of account when looking at minority shareholdings
  • Even if there is some restriction it will be diluted by the discounts being applied
  • For example, very simplistically, if put yacht worth £1m in to a qualifying business and you are looking at a 20% minority interest
    - shareholders share of excepted asset £200,000
    - after discount for minority of say 60% loss of BPR £80,000
  • In some circumstances can use the valuations to clients advantage.
Shareholder in Holding company is looking to transfer her shares in to a family trust
Holdco Group of Companies Limited  
Company only Balance Sheet as at 31 March 2014

<table>
<thead>
<tr>
<th>Note</th>
<th>2014 (£)</th>
<th>2013 (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIXED ASSETS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tangible fixed assets</td>
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<td></td>
</tr>
<tr>
<td>Includes freehold property at cost of £1m that is rented to the trading subsidiaries</td>
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</tr>
<tr>
<td>1</td>
<td>1,026,488</td>
<td>1,023,612</td>
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<tr>
<td>Fixed asset investments</td>
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<td></td>
</tr>
<tr>
<td>3 subsidiaries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>One trades and rents workshop from shareholder</td>
<td></td>
<td></td>
</tr>
<tr>
<td>One trades but has significant cash balances</td>
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<td></td>
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<tr>
<td>One is a property investment company</td>
<td></td>
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<tr>
<td>2</td>
<td>1,500,000</td>
<td>1,575,000</td>
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<tr>
<td>CURRENT ASSETS</td>
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<tr>
<td>Debtors</td>
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<tr>
<td>Investments (includes share portfolio)</td>
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<tr>
<td>3</td>
<td>20,251</td>
<td>16,464</td>
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<tr>
<td>Cash</td>
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<tr>
<td>2</td>
<td>5,415</td>
<td>12,362</td>
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<td>207,097</td>
<td>192,392</td>
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<tr>
<td>CREDITORS</td>
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<tr>
<td></td>
<td>(382,178)</td>
<td>(257,163)</td>
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<tr>
<td>NET CURRENT LIABILITIES (includes loan notes £20,000)</td>
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</tr>
<tr>
<td>4</td>
<td>(175,081)</td>
<td>(64,771)</td>
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<tr>
<td>TOTAL ASSETS LESS LIABILITIES</td>
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<tr>
<td></td>
<td>2,351,407</td>
<td>2,533,841</td>
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<tr>
<td>CAPITAL AND RESERVES</td>
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<tr>
<td>Called up share capital (£50,000 preference shares)</td>
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<td></td>
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<tr>
<td>5</td>
<td>50,100</td>
<td>50,100</td>
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<tr>
<td>Reserves</td>
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<td>2,301,307</td>
<td>2,483,741</td>
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<td>SHAREHOLDERS FUNDS</td>
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<tr>
<td></td>
<td>2,351,407</td>
<td>2,533,841</td>
</tr>
</tbody>
</table>
BUSINESS PROPERTY RELIEF
Case study suggestions

Note 1

Freehold property is used by the subsidiaries

- What is the market value of the property - would its value cause the holding company to fail the wholly and mainly test?

- In deciding whether the holding company shares qualify we need to look at each of the subsidiaries in turn to determine their value. Will need to include goodwill in this valuation

- If the property value was too high what could we do about it? Hive down in to one of trading subsidiaries or set up new subsidiary to hold the property.
BUSINESS PROPERTY RELIEF
Case study suggestions

Note 2

Subsidiaries

• Sub 1: Property outside the group. Only eligible for 50% BPR if the shareholder has control - bring in to the group? CGT/SDLT

• Sub 2: Cash in trading company - is any surplus? Can we support future use?

• Sub 3: Property investment company - currently value of company excluded from relief - could we spread the properties across the trading companies? As long as each trading subsidiary remains wholly or mainly trading then will increased the amount of relief due.
BUSINESS PROPERTY RELIEF

Case study suggestions

Note 3
• Are the shares excepted assets? Need to look at value and purpose
• Can they be extracted from the group?

Note 4
• Loan note will not qualify for relief unless has voting rights and those rights have to be taken in to account with the shareholding to ensure that the shareholder has control
• Could we capitalise the loan? Two year period of ownership needed unless rights issue

Note 5
• Both ordinary shares and preference shares will qualify for relief but have we looked at the Articles etc for buy sell arrangements?
BUSINESS PROPERTY RELIEF

Summary

• BPR is not straightforward - HMRC taking closer interest
• It is a fundamental part of capital taxes planning and an early review will help to identify any issues that could restrict relief and allow planning to be done to improve the position
• The accounts will play a key part of any review and the valuation approach adopted can have a significant impact on the outcome
• If there is a problem for BPR there will also be issues for other tax reliefs - entrepreneurs’ relief, holdover relief issues and possibly substantial shareholdings exemption issues.
AGRICULTURAL PROPERTY RELIEF

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**APR ESSENTIALS**

Importance of Agricultural Property Relief (APR)

Values of agricultural property can be substantial.....

- In 2013 the **average** value of UK farmland was £8,500 per acre
- 10-year cumulative average growth to 2013:
  - UK farmland 273%
  - Prime Central London values 135%

- More buying of agricultural land for investment
- Buyers not from traditional farming backgrounds

Farmhouse values can also be high -

- the APR myth for farmhouses?
APR ESSENTIALS

The legislation

Section 116 (1) IHTA 1984:

“Where the whole or part of the value transferred by a transfer of value is attributable to the agricultural value of agricultural property, the whole or that part of the value transferred shall be treated as reduced by the appropriate percentage.....”

Appropriate percentage is:

100% if:

• Vacant possession or can obtain it within 12 months (extended to 24 months by concession)
• Property is let on a Farm Business tenancy (tenancy beginning on or after 1 September 1995)
• Property owned since before 10 March 1981 and certain conditions apply (including AHA tenancies).

Otherwise, 50%
**APR ESSENTIALS**

Is the asset agricultural property?

Defined in Section 115 IHTA 1984:

Agricultural land or pasture, including:

- woodland and buildings used for intensive rearing of livestock or fish - only if occupied with the agricultural land
- cottages, farm buildings and farmhouses - subject to “character appropriate” test
- Habitat schemes/Countryside Stewardship Scheme/short rotation coppicing

Must be in UK or EEA

- Section 117 IHTA 1984 requires that the agricultural property is occupied for the purposes of agriculture - 2 years if farmed in hand, 7 years if let
- Diversification - risk areas.
**APR ESSENTIALS**

**Agricultural value**

APR is given on the agricultural value of the property i.e. the value if the property was subject to a perpetual covenant prohibiting its use otherwise than as agricultural property.

Market value may be higher e.g.: if land has development potential.

Assets valued at market value for IHT purposes - valuation is key

- get separate opinions for agricultural and open market values

Is BPR also available?
- Contract farming
- Grazing agreements
APR ESSENTIALS
Contract farming and grazing agreements

• Used to establish that land (and farmhouse) continues to be occupied for the purposes of agriculture (APR) or that the owner is farming (BPR)

• Written agreements essential

• Farmer / landowner and not the contractor should be in charge of farming operations and decision making

• Regular meetings with contractor

• Exposure to risk with no fixed return

• Who claims subsidies?

• HMRC scrutiny - keep arrangements under review.
APR ESSENTIALS

Farmhouses

APR is essential as farmhouses do not qualify for BPR (except parts used for business purposes)

Farmhouse must be:

- of a character appropriate to the holding of which it forms part
- occupied, together with land, for agricultural purposes
- common occupation is required but not common ownership - *HMRC v. Joseph Nicholas Hanson as trustee of the William Hanson 1957 Settlement (2013)*.

Occupation - *HMRC v. Atkinson & Smith (2012)* - APR refused where farmer was in care home for last 4 years.
Character appropriate test:

- Factors applied to determine if farmhouse is of a “character appropriate” listed in IHTM24051
- Checklist approach is not correct - overall picture gained from looking at the position “in the round”
- History of the farm may be relevant evidence - what records are available and how far back do they go? - Executors of Dennis Golding Deceased v HMRC [2011]
- Acreages are not conclusive - how is the land used?
- Farm use does not have to be commercial.
APR ESSENTIALS

Farming companies

• APR potentially available on that part of the value of the shares attributable to agricultural property

• BPR on remainder if trading on a commercial basis

• Only controlling shareholder can obtain APR

• Problem if company holds land which is let and no controlling shareholding - no APR or BPR (often found when partnerships incorporate)

• Other issues -
  - No PRR relief on farmhouses
  - Benefits in kind (job-related let out not available to directors).
Land used for grazing horses will qualify for APR if:

- there is a stud farming activity and the grazing is connected with that activity (HMRC review of what actually happens)
- the horses are working farm animals
- the horses are bred for horsemeat

• Other equine activities may qualify for BPR

• Recreational horses kept on a farm - advisable to keep on a small, defined and low value area of land.
APR ESSENTIALS

Woodlands

• Woodlands managed on a commercial basis & owned for two years - BPR

• Non-commercial woodlands occupied with agricultural land may obtain APR

• “Woodland relief” may defer tax on growing timber where neither APR nor BPR.
APR ESSENTIALS

Conclusions

APR is valuable and can be available where BPR is not
HMRC know this!

Risk areas -
• Diversification - is it agriculture?
• Use of farmhouse / character appropriate / etc
• Restriction to agricultural value
• Elderly / “retired” farmers

Key issues -
• Valuation
• Record-keeping

Getting it wrong can result in substantial penalties of up to 100% of the Potential Lost Revenue.
QUESTIONS