Dear Sirs

Business property relief

HMRC gave a helpful response over a year ago to certain questions posed by the CIOT/ICAEW in relation to groups. A copy of the document “TAXGUIDE 5/11 INHERITANCE TAX – BUSINESS PROPERTY RELIEF AND GROUPS OF COMPANIES” is attached for ease of reference.

I also attach a more complex holding company structure which is common in large privately owned groups with a number of different holding companies. This involves not just one TopCo (“A” on the diagram) holding 100% of companies in a vertical or linear progression i.e. A owns B owns C but a TopCo A with a number of “horizontal” underlying holding companies each effectively being its own separate group. So on the diagram A owns B which owns C1 and C2 and A owns D which owns E1 and E2. This horizontal structure is much more common as each sub-group often undertakes a different type of business. For this purpose assume that if one viewed the activities together the whole group would be mainly trading and assume also unless otherwise stated that there is no investment subsidiary caught by s111 IHTA.

Additional questions.

Commentary

At para 31 HMRC indicated that they do not consider there to be a limit on the maximum number of intermediate holding companies that can be in a group structure for the purposes of eligibility for business property relief, provided the Companies Act 2006 requirements are met. The question is whether each company needs to be considered strictly on its own merits to determine whether or not it should be considered relevant property, for example whether it is mainly trading or mainly carrying on the business of being a holding company.

Question 1

Can HMRC confirm that intermediate holding companies (as shown in the attached group arrangement) B and D should not prevent the shares of the parent company or the intermediate companies from being relevant property merely by the fact that there are horizontal and multiple levels of holding companies and sub-groups within the trading group.
Commentary

Each of the holding companies A, B and D shown in the attached structure holds 100% of the issued share capital in its direct subsidiary company (C1 and C2 in relation to B and E1 and E2 in relation to D).

For shares to be considered relevant property, the company must carry on a business of being wholly or mainly a holding company. As might be expected in such a group arrangement, the ultimate parent company A carries on much of the group-wide administration, coordination and management on behalf of its direct and indirect subsidiaries. Where intermediate holding companies have been put in place, they may be providing loan financing to their subsidiary, as well as enabling the ring-fencing of external debt provided to the group by third party lenders.

At para 34 of the ICAEW TAXGUIDE, HMRC state that:

“Assuming that in the example at Appendix 1 the three holding companies have no business other than holding shares in their respective subsidiaries (with what that entails), we would first of all agree that the business of the group as a whole does not fall within s 105(3), IHTA 1984. Then, considering in turn the businesses of all the subsidiaries – B Holding Co, C Holding Co and D Trading Co – we would agree that no restriction to the relief is required under s 111, IHTA 1984. The businesses of B Holding Co and C Holding Co fall within s 105(4)(b), IHTA 1984 while the business of D Trading Co does not fall within s 105(3), IHTA 1984 because it has a non-investment business (and is not dealing in shares, etc.).”

HMRC also published a view, at para 4.2 of correspondence with the CIOT in December 2010/January 2011 that requires consideration of the activities of a holding company so as to determine whether its business activities are sufficient to constitute “the business of a holding company”. This envisaged wider activities, such as those typically undertaken by the ultimate parent company but often done to a much lesser extent by intermediate holding companies.

Question 2

We would welcome confirmation that HMRC consider an intermediate holding company such as B or D that simply holds shares in its wholly owned trading subsidiaries and undertakes no other activities can be regarded wholly or mainly as a holding company for the purposes of s105(4)(b). It seems that holding shares in a subsidiary must be considered a holding company activity and therefore I assume there is no difficulty about this.

Commentary

As well as equity, most of the parent and intermediate parent companies have made intra-company loans to their direct subsidiaries. HMRC have previously issued guidance in their correspondence with the CIOT in December 2010/January 2011 confirming that a company that provides debt financing to its subsidiary should not be considered to have made an investment provided the amount is “reasonable in the context of the group as a whole”. However there are various nuances to this which make the subject difficult and on which it would be helpful to have your views.

Question 3

It is assumed that intermediate holding companies in the attached group structure should not be considered to have made an investment by providing financing to their subsidiary companies. i.e. HMRC’s view has not changed. It is also assumed it does not matter whether such loans are interest bearing or not. Debt finance provided by a shareholder is often not commercial.
Question 4

Sometimes the holding company (whether intermediate or TopCo) will be the holding company of a trading group and lend to both its trading and investment subsidiaries. If say D HoldCo lends to E1 trading and E2 investment but E1 trading activities predominate, E2 will be disqualified by virtue of s111 but D will still be a qualifying holding company as lending to E1 and E2 is in both cases a holding company activity i.e. its loans to E2 are accepted to be part of its HoldCo activities? Provided E2 does not predominate then D is qualifying. D is valued taking into account all its loans and debt to A but anything attributable to E2's net value (after taking into account the loans to D) does not qualify. I cannot see why only loans by D to E1 would be treated as holding company activities.

Question 5

If the position was reversed and E2 predominated then presumably D will not be a qualifying holding company at all and then it would be a matter of considering whether D's value was sufficient to make the wider group mainly investment. Do HMRC agree? It is assumed you do not simply add up all the values of the subsidiaries and net off trading vs investment. So if for example D HoldCo was 35% of total value of A group and all of B and C1 and C2 are trading but E2 outweighed E1 in value then D would not be a qualifying HoldCo at all. That would then mean business property relief could only be given on the value of B and its subsidiaries. But if one looked at E1, B, C1 and C2 in relation to value then some relief could be given to E1. Is the first interpretation correct?

Question 6

Sometimes the intermediate HoldCo lends to companies not in its own immediate group but to companies in other sub-groups within the overall group or lends back up to TopCo to sort out some temporary cash flow problem. So D lends to C1 or to B.

Does HMRC ignore loans within the total group or regard such loans as investments as they are not as such holding company activities or does HMRC treat such loans as permissible being part of general holding company activities? If it is important for loans to be ringfenced within each group so that intermediate HoldCos can only lend downwards then taxpayers should be made aware of this.

Question 7

What if the TopCo lends to the intermediate holding company to fund that company's activities and the intermediate HoldCo just uses the money for its own expenses (including its holding company activities) rather than for its trading subsidiaries. Presumably there is no difficulty here provided the overall criteria of being mainly a holding company of a trading group is satisfied.

Question 8

Finally if HoldCo A carries on 75% trading in its own right and 25% HoldCo activities as holding company of a trading group strictly the 25% is an investment activity not within the s105(4)(b) let out. In this example HoldCo A should still qualify for relief being mainly a trading company. However if the position was such that A carries on 45% trading activities and 10% investment activities in its own right and 45% acting as holding company of a trading group then A shares would not qualify for any relief as both the 10% and the 45% would technically be investment activities even though 90% of the group is trading. Does HMRC adopt this latter view or simply look at the group activities as a whole and give relief to A?
I look forward to hearing from you.

Emma Chamberlain
Barrister
Dear Emma

Business property Relief

Thank you for your letter of 21 April 2015, addressed to Tony Key. Please excuse the delay in replying, owing to other work on the summer 2015 budget.

You raise a number of questions in connection with group structures and financing and also refer to the CIOT/ICAEW Taxguide 5/11.

I am able to answer as follows:

Q1: HMRC can confirm that intermediate holding companies B and D should not prevent the shares of the parent company or intermediate holding companies from being relevant business property merely by the fact that there are horizontal and multiple levels of holding companies and sub-groups within the trading group.

Q2: HMRC can also confirm that an intermediate holding company such as B or D that simply holds shares in its wholly owned trading subsidiaries and undertakes no other activities can be regarded wholly or mainly as a holding company for the purposes of S.105(4)(b).

Q3: this question concerns intra-group financing and HMRC’s comment that a company that provides debt financing to its subsidiary should not be considered to have made an investment provided the amount is ‘reasonable in the context of the group as a whole’. The position is the same for intermediate holding companies, and we would still look at whether the arrangement was reasonable. We agree that intra-group finance sometimes consists of non-interest bearing loans, and we do not think it matters for these purposes whether the loan is interest bearing or not.

Q4: We would apply the same analysis here as to what is ‘reasonable’. In some circumstances, we may consider the loan to E2 to be an investment, for example if the loan appeared to be excessive or
unnecessary.

Q5: We agree with your first interpretation.

Q6: There are two parts to this answer. First, we do not consider that there is a requirement in a group context for lending to be ringfenced so that lending can only be made directly downwards. Second, we would apply the same analysis as at Q3 and Q4 above to lending between sub-groups such as D lending to C1, and B lending to E2.

Q7: We agree that there would be no difficulty here if the topco lends to the intermediate holdco purely to use for its own expenses. If intermediate holdco's activities included the provision of finance, we would again need to carry out the analysis as above.

Q8: In the second scenario, HMRC would look at the group activities as a whole. The shares in A would qualify for relief in both scenarios.