End of an era

Inheritance tax and trusts



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Antonia Vanbergen explains why business property relief is so valuable

Key Points

What is the issue?

Business property relief is an inheritance tax relief available to individuals who are considering gifting business property during their lifetime and to executors dealing with estates

What does it mean to me?

When advising on succession planning for your clients, BPR is a valuable relief that can reduce the IHT burden, but it comes with a few conditions and caveats

What can I take away?

An overview of the rules and conditions for BPR and a general understanding of what may restrict the relief available

Business property relief (BPR) is a valuable succession planning tool that can reduce any inheritance tax (IHT) payable on transfers of relevant business property in an individual's lifetime or when they die. If available, BPR can reduce the taxable value of the transfer by 50% or 100%, depending on the type of property transferred.

Usually when a gift is made to another individual, the value in excess of any nil rate band is chargeable to IHT, should the donor die within seven years. Similarly, if a gift is made to a trust during an individual's lifetime, lifetime tax may be payable. If BPR is available, it can reduce the value of a transfer to nil.

Relevant business property

Assets qualifying for 100% BPR can be summarised as:

- shares in an unlisted company;
- a sole trader business or share in a partnership; and
- shares listed on the Alternative Investment Market (AIM).

There is no minimum percentage holding requirement, and entities based overseas can also qualify.

BPR is available at 50% on these assets:

- shares in a quoted trading company in which the individual has voting control; and
- land, buildings or plant and machinery owned by the individual and used in their partnership or a company that they control.

BPR is also available at either 50% (quoted) or 100% (unquoted) on loan notes or debentures in a company in which the individual has voting control.

HMRC may seek to deny BPR if a binding contract for sale is in place, which could be specified within the partnership or shareholders' agreement should the individual die. The use of cross-options, which give each party (executors and surviving business partners) an option to buy or sell the asset, can be used instead.

Ownership period

Relevant business property qualifies for BPR when the individual or trust has owned it for at least two years. However, BPR may still be available before this in some circumstances:

- the ownership period can be aggregated with a spouse if transferred when the spouse dies;
- if there are two successive transfers, one of which is on death and the earlier transfer qualified for BPR; and
- if business property is sold but then replaced within three years, BPR may be given if, together, both assets were owned for two of the previous five years.

Trading requirement

The business must be 'wholly or mainly' trading to qualify. Case law has established that 'mainly' trading equates to at least 50% and factors such as turnover, profits and asset base may be considered individually, but the business will be assessed as a whole.

Therefore, if a business (which is considered to be trading) also holds, for example, a property that it lets, it can still qualify for BPR if the letting part (non-trade element) is less than 50% of the whole business.

Property lettings

Businesses with activities consisting wholly or mainly of the letting of land will not be eligible for BPR. In contrast, the provision of a hotel room is more likely to be seen as a trade and finding the balance between these two extremes can be complex. This would apply when considering furnished holiday lettings (FHLs). In the past, it was generally accepted that BPR would be available to FHL businesses. But this changed

with a landmark case in 2013.

In *HMRC v Pawson's Personal Representatives* [2013] UKUT 050 (TCC) (Pawson) it was established that, for the business to qualify for BPR, extra services had to be significant in addition to the letting of property. Cleaning, washing bedding, television and garden maintenance did not constitute significant activities in this case and BPR was denied on the grounds that the business was not wholly or mainly trading.

Excepted assets

Once it has been established that BPR is available for a business, some restrictions still need to be considered. The relief depends on whether the business holds any 'excepted assets'.

These relate to an asset that has not been used in the business for the two years before transfer and will not be required for future use in the business. Common examples of excepted assets are large surpluses of cash that have not been earmarked for future use or shares held by the business for investment purposes. Property owned by a business in which a shareholder is currently living, would also be included.

It is important to distinguish between 'the business' and 'the trade'. The asset does not have to be used in the trade itself, just in the business. Therefore, a property that is let to a third party by a business that is mainly trading may not be considered an excepted asset as long as it is used within the business as a whole.

In *Barclays Bank Trust Co Ltd v CIR* [1998] STC (SCD) 125, the company had a significant cash holding. Although it was agreed that part of the cash balance was needed in the business, the excess was treated as an excepted asset and hence restricted the BPR available.

A practical point to consider is that detailed reviews of the accounts may need to be undertaken when an individual owns relevant business property but is not necessarily involved in the business itself. This would ascertain the extent to which the business is trading, and also whether it holds any excepted assets.

Groups of companies

The same general principles apply when advising an individual who owns shares in the holding company of a group. In this instance, the group would need to be considered as a whole and, if found to be ‘mainly’ trading, BPR would be available for the shares.

The next step would be to evaluate each subsidiary individually. If any subsidiary is not considered to be mainly trading, it would be treated in much the same way as an excepted asset. The BPR would be restricted according to the market value of that investment subsidiary. Matters can become complicated when dealing with large group structures.

Ongoing considerations

There are potential pitfalls when gifting assets during an individual’s lifetime. For example, if the donor dies within seven years of a transfer and the recipient no longer holds the asset (or a qualifying replacement asset), BPR will not be available. The control over the asset has moved from the donor to the recipient. In addition, BPR will be given only if the qualifying conditions are met on death.

Should the recipient dispose of part of the asset, they would secure BPR only on the element retained. Taper relief may also be available to reduce the resulting IHT.

Interaction with capital gains tax (CGT)

There is often an overlap between IHT and CGT when advising on the transfer of business assets. Assets that will qualify for BPR are also likely to meet the qualifying conditions for entrepreneurs’ relief (ER), although in some respects those for BPR are easier to meet. For example, the 50% trading requirement is more generous than the ‘substantially trading’ condition that applies to ER, for which generally a minimum of 80% trading is required.

There is no requirement to work in the business to obtain BPR. In addition, there is no limit on the value of property that can qualify for it, whereas ER has a £10 million lifetime limit on qualifying capital gains.

Holdover relief for CGT goes hand-in-hand with BPR on transfers during an individual’s lifetime. It freezes any gain until the assets are finally disposed of. Therefore, should an individual gift business assets with unrealised gains to an individual or trust, they could end up with no immediate tax liability.

Unlike other types of succession planning, when considering BPR it may be of benefit to retain the business assets until death. This is due to the CGT uplift that applies to property forming part of the death estate eliminating any unrealised gains. If an asset then qualifies for BPR, IHT can also be reduced to nil, making the use of this relief an efficient way to pass assets to the next generation.

Conclusion

BPR is a valuable relief that can have a material effect on reducing the IHT burden on individuals and trusts. When combined with other reliefs, sometimes the overall tax liability can be reduced to nil. It is therefore worth keeping in mind the general conditions that apply for BPR.