

Business Property Relief – Still a Controversial Issue

Yet another inheritance tax business property relief case has surfaced at the Special Commissioners. The case has a number of features which are peculiar to its own facts, but nevertheless there are some important conclusions which can be drawn from the decision.

The case concerned is the *Fourth Earl of Balfour* and it concerns a Scottish estate which included extensive farming activities, as well as the letting of some 28 farm cottages. It appears that much of the land was, until November 2002, included in a will trust in respect of which the late Earl of Balfour had a life interest, but he conducted farming activities on the land and the rental income was also received by him under the life tenancy. In November 2002 the life interest was terminated under the provision of a Scottish Act relating to entails, and thereafter the late Earl owned the land outright, until his death in June 2003.

The evidence given in the case was that the trading turnover from farming was, in all years, greater than the turnover from letting of properties and cottages, although the latter demonstrated an increasing trend. It was also stated in evidence that the Earl managed all the properties as a single unified business, but he spent the greater part of his time on farming operations rather than the letting of cottages. Where at all possible, it was said that the Earl preferred to let the cottages to estate employees or to individuals who have the necessary skills to be of benefit to the estate.

After reviewing all these facts, the Special Commissioners decided that the whole estate qualified for 100% business property relief from Inheritance Tax. HMRC had argued that the business was one of mainly holding or making investments, and furthermore the two year ownership test was not satisfied since much of the land was received from the trustees of the will trust within the one year period prior to the date of death. The Commissioners rejected both these arguments, and held that the Earl conducted farming and letting activities on the land as a unified business for at least the two years prior to the date of his death and those activities were predominately trading activities.

It is interesting that the income from letting and from farm trading was considered gross without the deduction of expenses. One guesses that net of expenses the farm trading profits would have been lower than the letting income, but for the purposes of the appeal the position was tested by reference to gross turnover.

Possibly the most surprising feature of the case is that HMRC decided to contest it before the Commissioners at all. If a person spends most of their time on trading activities, derives most of their income from those activities and most of the land involved is devoted to the trade, in what respect can there possibly be a business which is mainly one of making or holding investments? What's more, it is understood that HMRC intend to appeal the decision which one would have thought was a perfectly sound one on the facts .

Business property relief in relation to property based businesses is becoming increasingly contentious. The Special Commissioner made some comments to the effect that an investment activity is normally passive in nature and "once the

investment is made the return, if any, will follow generally because of the soundness of the investment and the state of the market in which the particular investment is made rather than the continuing efforts of the owner of the funds or property invested". These were helpful remarks for those who conduct property management activities on a full time basis.

If the case does go to the High Court, one would have thought that the taxpayer has a strong chance of success. Hopefully we will also be given further judicial guidance on how to identify an investment business where the underlying assets are properties. However the main lesson is that HMRC is increasingly contesting IHT business property relief claims where a business has a significant investment element. Although the law has remained broadly unchanged since 1976 virtually all appeals on the legislation have been over the past ten to fifteen years, and new ones keep surfacing regularly. Mixing investment and trading activities in one business is clearly something to be considered very carefully as there can be Inheritance Tax benefits as well as risks.

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