INHERITANCE TAX
BUSINESS PROPERTY RELIEF

A technical outline of the tax planning opportunities
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INDEX:

INTRODUCTION:

Generally trading businesses qualify for 100% business property relief from inheritance tax. Strictly speaking it is not the businesses that benefit directly it is the beneficiaries of the estate of the business owners. Business property relief (BPR) provides an extremely effective way to protect the family business from a perhaps terminal 40% IHT tax charge when a major shareholder or business owner dies.

However, there are a number of quirky rules that both offer opportunities for effective tax advice and traps to avoid. This publication includes both varieties.

It is assumed that the basic rules are understood by practitioners but for completeness we have included extracts from HMRC manuals and legislation which practitioners may find useful.

PLANNING OPPORTUNITIES

1. Mainly trading

A business (run by a partnership or a company) must be mainly trading (but excluding dealing in shares, securities or land) to qualify for relief. Mainly means more than 50% but 50% of what? Generally one would look at factors such as turnover, employee time and management time. Factors such as asset value and profitability are much less important.

Thus, for example, a company can hold a significant level of investment assets and still qualify for relief. This is subject to the excepted asset rule considered below.

2. Excepted assets – investments

If a business qualifies as mainly trading (see above), relief is available but can be restricted by value within the business attributable to "excepted assets". Excepted assets are defined as assets not used wholly or mainly for the purposes of the business throughout the previous 2 years nor required for the future use of the business.

Note that the definition refers to business – not trade. For companies in particular, an investment activity is generally regarded as part of its business.

Opportunity

A trading company can own a significant level of investment assets such as property and still be eligible to 100% relief. However, care is required to satisfy the mainly test otherwise all relief is lost.

3. Excepted assets – cash

The asset commonly caught by the excepted asset rule is cash. This might happen where a profitable business has accumulated cash over the years and now has much more than it needs for day-to-day use.

Possible solutions include:

- Buying investment assets (see above)
- Regularly looking for opportunities to make purchases and taking advantage of the future use rule. Evidence should be retained of efforts (perhaps, for example, recorded in minutes of directors' meetings). The efforts need to be more than token and some purchases actually made periodically.

4. Groups of companies

Generally the business of a group is looked at as a whole to determine whether relief is due. However, if an individual subsidiary company fails the mainly trading test, relief for the parent company shares is restricted by the value of that subsidiary (rather like an excepted asset).

Thus investment assets should be held by the parent company (which need not be trading) or by trading subsidiaries.

5. Ownership period

Shares must be owned for at least 2 years to qualify for relief. However, the mainly trading test only needs to be satisfied at the time of transfer or death, not throughout the 2 year period.

RISK AVOIDANCE:

1. **Property held outside a company**

   It is common for business property used by a family company to be held directly by the shareholders. Such property only qualifies for 50% relief and this only if the company is controlled by the individual and his spouse. If the company is not controlled, there is no relief.

   Trap

   A trading business owned 50:50 with its own trading premises is owned by two individuals (not spouses or civil partners) in partnership. It is decided to incorporate the business to save income tax and national insurance. The decision is made to keep the property out of the company (for commercial protection or to save stamp duty land tax perhaps). As a partnership asset, the property qualifies for 100% relief. Held outside the company there is no relief as neither former partner controls the company.

2. **Property used by a sole trader**

   Property owned by a sole trader and used in his business qualifies for 100% relief. But if the property is in different ownership, e.g. the sole trader and his spouse, no relief is available including that part owned by the sole trader.

3. **Contracts for sale**

   If a binding contract for sale for an asset has been entered into, that asset cannot qualify for relief. Beware clauses in partnership or shareholder agreements that force others to buy the business interest of a deceased person. This can be avoided by, for example, use of cross options.

COMPLIANCE ISSUES:

A claim for BPR would normally be made during the settlement of the business owner's estate liability to IHT.

APPENDIX 1 – HMRC relevant web site notes

http://www.hmrc.gov.uk/inheritancetax/pass-money-property/business-relief.htm

What qualifies for Business Relief?

You can claim Business Relief on:

- a business or an interest in a business
- unlisted shares (shares that aren't listed on a recognised stock exchange), including shares that are traded on the Alternative Investment Market
- a holding of shares or securities that you own which give you control of a company, that are fully listed on a recognised stock exchange
- any land, buildings, plant or machinery you own, used wholly or mainly in the business during the last two years before the business was passed on (or since your business acquired them if more recent)
- any land, buildings, plant or machinery used in your business and held in a trust that you had the right to benefit from

What doesn't qualify for Business Relief?

You can't claim Business Relief if:

- the business or company mainly deals with securities, stocks or shares, land or buildings, or in making or holding investments
- the business is a not-for-profit organisation
- the business is subject to a contract for sale, unless the sale is to a company that will carry on the business and you'll be paid wholly or mainly in shares of the acquiring business
- the company is being wound up, unless this is part of a process to enable the business of the company to carry on

You can't claim Business Relief on a business asset if the asset:

- also qualifies for Agricultural Relief
- was not used mainly for business in the two years immediately before you passed it on as a gift during your life or as part of your will
- is not required for future use in the business

If part of a non-qualifying asset is used in your business, that part might qualify for Business Relief. For example, if you use one room in a building as a shop and the other rooms are used as your home, the shop will qualify for Business Relief but the rooms won't.

Top

Rates of Business Relief

If the asset qualifies for Business Relief, relief is given at either 50 or 100 per cent, depending on the type of asset.

For the estates of people who died after 6 April 1996, **100 per cent relief** is available for a business or interest in a business, or a holding of shares in an unlisted company.

The **50 per cent relief** rate is available for:

- shares controlling more than 50 per cent of the voting rights in a listed company
- land, buildings, plant or machinery used in a business that you are a partner in or control at the time of your death
- land, buildings, plant or machinery held in a trust where you have the right to benefit from the trust and use the assets in the trust in your business

Top

Giving away business property or assets

You can give away business property or assets while you're still alive without putting Business Relief at risk, as long as the property or assets qualify for Business Relief in the first place.

If you give away business property or assets in your lifetime, whoever you give them to must keep them as a going concern until you die in order to keep the relief. They can replace the property or assets - like machinery - with something of the same value if it's for use in the business.

If you live for seven or more years after making a gift, anything you give away will not be classed as part of your estate for Inheritance Tax purposes. However, there may be Capital Gains Tax or Income Tax implications if you do sell, give away or exchange - 'dispose of' - an asset or property if it's gone up in value during the time that you owned it.

It may be helpful to discuss the implications of giving away business property or assets with a solicitor. You'll find some links below to professional organisations - though not all professionals are registered with them.

APPENDIX 2 – HMRC relevant statutory references

Practitioners can access HMRC manual references to BPR issues using the links in the following tables:

Business relief

1.1 Introduction

IHTM25001	Introduction

1.2 Investigating business relief and businesses

IHTM25011	Introduction
IHTM25012	Reviewing form IHT413 or D38

1.3 Investigation in 100% relief cases

IHTM25021	Introduction
IHTM25022	Business interests – chart for relief on death
IHTM25023	Business interests – chart for relief on potentially exempt transfers
IHTM25024	Business interests– chart for relief on chargeable lifetime transfers

1.4 Valuing businesses and partnerships

IHTM25051	What is a business?
IHTM25052	Business accounts
IHTM25060	Business terms

Valuing the business

IHTM25081	Investigating the profit and loss account
IHTM25082	Investigating the balance sheet

What is a partnership?

IHTM25091	Introduction
IHTM25092	Investigating partnership deeds
IHTM25093	Cases where there are no deeds
IHTM25094	Limited liability partnerships

Valuing the partnership interest

IHTM25101	Introduction
IHTM25102	Partnership share
IHTM25103	The balance sheet
IHTM25104	Freehold and leasehold property
IHTM25105	Agricultural land tenanted by a partnership
IHTM25106	Agricultural land owned by deceased and occupied by a partnership
IHTM25107	Milk quotas

1.5 Business relief

Relevant Business Property: Settled property used in the life tenant's business

IHTM25241	Rate of relief
IHTM25242	Property within s.105(1)(e)
IHTM25243	Scope of s.105(1)(e) in practice

Relevant Business Property

IHTM25250	Partnership interests
IHTM25251	Woodlands syndicates

Investment businesses

IHTM25261	Introduction
IHTM25262	Exceptions
IHTM25263	Wholly or mainly
IHTM25264	Dealing in land or buildings

Investment businesses: Caravan sites and furnished lettings

IHTM25271	General
IHTM25272	Property consisting of a business
IHTM25273	Meaning of “investment”
IHTM25274	Land as a business asset
IHTM25275	Lettings of commercial premises
IHTM25276	Furnished lettings
IHTM25277	Hotels, Bed and Breakfast and Residential Homes
IHTM25278	Holiday lettings
IHTM25279	Caravan sites
IHTM25280	Other lettings

Contracts for sale

IHTM25291	Introduction
IHTM25292	Shareholdings and partnership interests

The ownership test

IHTM25301	Introduction
IHTM25302	Meaning of ownership
IHTM25303	Changes in the nature of the business

Replacement property

IHTM25311	Introduction
IHTM25312	Chart
IHTM25313	Limitation of relief
IHTM25314	Minority holdings of unquoted shares

Successions

IHTM25321	Introduction
IHTM25322	Chart

Successive transfers

IHTM25331	Introduction

MARKETING COPY:

The copy set out below is in the form of a letter to a client or prospect. Equally the text could be copied into web site material or other marketing documentation.

Dear ,

Protecting your business assets from a 40% inheritance tax charge

None of us likes to spend too much time reflecting on what happens to our hard won assets when we die – after all we will not be around to feel the pain! But of course our family will and there are legitimate planning opportunities you should be considering now.

This article focuses on the business assets of trading concerns, for instance shares you own in your business or commercial property that you own personally but which is used by your business.

Business property relief (BPR) is very generous. Depending on the type of asset your estate may qualify for between 50% and 100% relief for inheritance tax purposes. Planning is critical to avoid losing this relief. This can happen if your affairs are not organised to maximise the relief available. For example:

1. Let’s say you run a trading partnership (your partner is not your spouse or Civil Partner) and share profits 50:50. You decide to incorporate your business, turn it into a limited company, and have 50% of the shares each. Your commercial premises are not transferred to the limited company to save on stamp duty. As a partnership asset the commercial premises would attract 100% BPR. After transfer of the trade to the limited company no relief would be available – the reason; property held outside a business qualifies for BPR but only if the person making the claim has a controlling interest in the business. In our example neither partner has control.
2. A property owned by a sole trader and used in his business qualifies for 100% BPR. However, if the property in held in joint names, say with a spouse, no relief is available.

If you have business interests or own commercial property used by your business we recommend that check out the availability of BPR as part of a general inheritance tax planning review.

We can be contacted at: (enter contact details, if possible use the name of partner, tax specialist that will offer the advice).

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If you subscribe to our Practice Gateway product and you decide to showcase this tax product you could use the following copy to intrigue visitors to your web site.

Business Property – shelter from inheritance tax

If you own commercial property, either personally or within your business, have you considered the inheritance tax consequences – they can vary from 0% to 40% tax payable by your estate. >>Contact us for more information

(hyperlink Contact Us to a std email reply form)

A subscription to our Practice Gateway product can be ordered online at:

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