

Landed Estates Update

Sowing the seeds for future prosperity

Trading status will minimise Inheritance Tax

Welcome to the first edition of Landed Estates Update, our new publication for owners of Landed Estates and their advisers. In this issue we will be focusing on Inheritance Tax (IHT), and in particular securing Business Property Relief (BPR) on the estate.

Background

There are two main reliefs from IHT for an estate, Agricultural property Relief (APR) and BPR. APR is available on agricultural land and property, giving relief of up to 100% on the agricultural value of the land. BPR is available on a qualifying business and gives relief at 100% of the

market value of the assets in the business, and is consequently potentially more valuable.

The case law

In order to qualify for BPR the estate must be run as 'wholly or mainly' a trading business i.e. more than 50%.

There are two key cases in this area, Farmer v IRC 1999 SpC 216 and more recently Brander (Personal Representative of the late. 4th Earl of Balfour) v HMRC [2010] UKUT 300 (TCC), commonly known as the Balfour case.

Both cases concerned an estate with both in-hand farming, let farm land and let cottages. When considering if the business was 'wholly or mainly' a trading or an investment business the following factors were considered:

- The capital employed in the trading and letting business
- The acreage of farmed and let land
- The split of turnover between the trading and letting
- The net profit attributable to the trading and letting
- The time spent by directors/ employees in each business, including contractors in the farming business
- The overall context of the business

When looking at these factors no single factor is conclusive. Instead it is necessary to look at the business in the round to reach an overall conclusion

In Balfour data was looked at in the eight year period prior to the claim for BPR being made and showed the importance of good record keeping.

Continued overleaf...



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Trading v non trading (investment)

The major trading business for any estate is farming and how this business is structured is critical for the trading status of the estate as a whole. Where the farming is carried out in-hand the estate is clearly carrying out a trading activity. Conversely when the farm land is all tenanted and the estate merely receives a rental income, the farm land is part of an investment business.

Management of woodland, sporting activities and other ventures such as a farm shop will count as trading activities.

Let cottages will be generally treated as an investment business. Where an estate runs furnished holidays cottages, however whether or not they are trading assets depends on the services offered as part of the holiday. Where the estate is merely cleaning and preparing the cottages, finding the tenants and generally maintaining the cottages this will not be sufficient to qualify the activity as trading. Where, however, extra services are provided, such as meals, childcare and recreational activities the cottages may qualify as trading assets.

For those estates that do not wish to own the machinery needed to farm the land themselves, but need to ensure that they are wholly or mainly trading, then either contract or share farming are alternative routes. In both cases the landowner is farming and will meet the conditions for trading.

The key in both agreements is that the landowner is actively involved in decision making in the farming business and is subject to financial risk. If these factors are not present then the agreement may be no more than a glorified rental agreement.

Structuring a tax efficient business

In order to maximise the availability of relief there must be one business, the greater part of which must be trading and the balance of which can be investment. Where ownership of the estate assets is in different hands e.g. trusts and individual ownership a partnership between them is the best way of achieving the desired structure.

Typically each party will introduce the assets that they own to the partnership, with all assets being shown on the balance sheet, creating a combined estate business. Careful drafting of the partnership deed is important in determining how the partnership will operate, what assets are introduced by each partner and what happens if the partnership is dissolved at some stage in the future.

Particular care is needed with regards to both Stamp Duty Land Tax (SDLT) and Value Added Tax (VAT). Where assets are transferred to a partnership there is no SDLT charge provided that all parties transferring assets to the partnership are connected. If this is not the case, and it may well not be where trustees are involved, then there is potentially an SDLT charge, most likely at 4%.

If one of the parties transferring land to a partnership is VAT registered and has opted to tax part of the land, then there is likely to be a chargeable supply for VAT. Providing the partnership is registered then the VAT is reclaimable, but this can create cash flow issues.

On-going review

When a claim is made for business property relief the qualifying conditions are looked at over the preceding two years. Estates are continually evolving and looking at new ways of generating income to support themselves. Each change in activity could affect the overall balance of the estate when considering if it is trading, as well as factors outside the control of the owner such as changes in land and property values and farming income and profitability. Consequently it is necessary for the estate to continually review the business overall to ensure that it continues to qualify as trading.

For example land that is being farmed may be let to a quarrying company. Once the farming ceases the estate will receive a rent, moving both the land value and the income to the investment side of the business.

Example

Consider a mixed estate with say 3,000 acres, currently let, and 30 let properties, with values of say £15 million for the land and £10 million for the properties. The

land should qualify for APR at 100% and the let properties would be subject to IHT, giving a potential liability of £4 million. If however the land can be farmed by the estate, and a single composite business created, there is potential for BPR to apply to all the assets, giving an IHT saving of £4 million.

Conclusion

The IHT benefits for a mixed estate of establishing a BPR qualifying business are likely to be significant. However it may take time to establish the business, particularly where land is currently let, and will need constant review to ensure that the business remains 'wholly or mainly' trading. Where assets are in different ownership care must be taken to ensure that there are no unwanted tax charges in forming the new business and advice should be taken at the outset.

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Nicholas specialises in Private Client tax advising individuals and trustees on all aspects of their tax affairs including minimising income tax liabilities, capital gains tax planning and inheritance tax planning.

Nicholas started his career with Procter & Gamble making Fairy Liquid before joining PricewaterhouseCoopers in Reading for 5 years. During this time he qualified as a Chartered Accountant and Chartered Tax Adviser, working extensively with the estates and bloodstock team. In September 2006 he joined Hazlewoods, returning to Gloucestershire where he grew up. Nicholas is a member of the Gloucestershire committee of the CLA and away from work he enjoys horse racing, hunting and riding.



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