

CHAPTER 7

BUSINESS PROPERTY RELIEF

7.1 Introduction

Business property relief (BPR) reduces the transfer of value for inheritance tax purposes. **BPR is given before any annual exemptions.**

[IHTA 1984, s.104](#)

Value transferred	X
Less: BPR @ 50%/100%	<u>(X)</u>
	X
Less: annual exemptions	<u>(X)</u>
Chargeable transfer	<u>X</u>

Consequently a gift of business property to a discretionary trust will result in a lower amount of IHT being payable. In some instances, the relief will extinguish the transfer of value completely.

BPR is also available to reduce the value of business assets in a death estate. **BPR is given automatically if the conditions for relief are satisfied.** There is no formal requirement to claim business property relief.

6.2 "Relevant business property"

[IHTA 1984, s. 105](#)

BPR is only given if a donor makes a transfer of **"relevant business property"**. The definition of relevant business property is given at Section 105 IHTA 1984.

If a donor transfers a **business** or a **share in a partnership**, this transfer will qualify for business property relief. BPR is not available on the transfer of a single business asset.

Therefore if a sole trader transfers the whole of his business into a discretionary trust, the gift will qualify for BPR. However if he transfers **part of his business** - for example a piece of machinery or a building used in the trade - he will **not receive any BPR**.

This practice has been thrown into doubt by the case of *Nelson Dance Family Settlement Trustees v HMRC*.

In this case a farmer transferred some of his farmland (but not the farming business) to a trust. The farmland had considerable development value. BPR was claimed against the development value. The Special Commissioners found in favour of the taxpayer and allowed BPR. The High Court on appeal affirmed this decision. HMRC were given leave to appeal.

The decision to allow BPR was based on the underlying principle of IHT, that the transfer of value was based on the "loss to the donor". The value of the farming

business held by the farmer had reduced. **A loss had occurred to the donor and therefore BPR was available on the fall in value of the farming business.** It did not matter that the loss was due to the transfer of a piece of farmland which was no longer going to be used in the business.

It is not clear whether this now gives the taxpayer carte blanche to claim BPR on the transfer of an isolated business asset and if so, whether HMRC are planning to rectify the situation. It is still possible that HMRC will either appeal the Nelson Dance decision or alternatively amend the legislation to restore the original position whereby BPR is only available on the transfer of a business or an interest in a business.

Shares in unlisted trading companies are relevant business property for IHT purposes. Any number of shares will qualify - there is no minimum holding.

Shares in a quoted trading company will only constitute relevant business property if **the donor has voting control** of the company. To have voting control of the company, the donor must usually own **more than 50%** of the ordinary shares. It is extremely rare in practice for one individual to hold more than 50% of the shares of a quoted company. Therefore in the vast majority of instances, shares in quoted plcs will not qualify for business property relief.

Land or buildings or plant and machinery owned by an individual and **used either by his partnership or a company he controls**, will also qualify for business property relief.

"Related property" is taken into account in determining "control".

Therefore if an individual owns 51% or more of the shares of a company, he will receive BPR on a transfer of those shares. If the individual owns assets personally which are used by that company, he will also receive BPR on a transfer of those assets.

7.3 Rate of relief

[IHTA 1984,
s. 104](#)

BPR will either be given at a rate of **100% or 50%**.

Transfers of **businesses or shares in unquoted trading companies**, will qualify for **100% BPR**. This will usually mean that the transfer of value is completely extinguished by business property relief and no tax will be payable.

Transfers of **shares from a controlling holding in a quoted trading company** will qualify for **50% relief**. The 50% rate also applies to gifts of **land and buildings and plant and machinery** by a donor where those assets are **used by his partnership or by a company he controls**.

All the information above is easily accessible from Section 105 IHTA 1984.

7.4 Other points

If shares are to qualify for business property relief, they must be shares in a **trading company**. Shares in **investment companies or property dealing companies will never qualify** for business property relief.

[IHTA 1984,
s.105\(3\)](#)

For the purposes of BPR, the term "quoted" means the company has a full listing on the Stock Exchange. Shares on the Alternative Investment Market ("**AIM**") are treated as **unlisted** shares for BPR purposes.

In the past **furnished holiday lettings (FHLs)** had **not been treated as relevant business property** for inheritance tax purposes. However, this view had been challenged in several cases brought before the Courts and HMRC has revised its opinion on the availability of BPR on FHLs.

Under s.105(3) IHTA 1984, **BPR is not available on an asset used in a business which consists wholly or mainly of dealing in land or buildings**. Historically HMRC had denied BPR on FHLs on this basis. However, HMRC's IHT Manual (IHTM25278) states that FHLs will qualify for BPR where the lettings are short-term (weekly or fortnightly) and the owner (or agent) is substantially involved with the holidaymakers in terms of their activities on and from the premises.

Therefore BPR will still be denied on FHLs if the landlord does not provide any services to the holidaymakers. However, where services are provided, the HMRC accept that there is little or no distinction between a FHL and a hotel / bed-&-breakfast business on which BPR will be available.

Note that the usual tests for determining whether a property qualifies as a FHL (ie, the 140 day "availability" test, and the 70-day "letting" test) apply for income tax & CGT only - these tests do not apply for IHT.

If an individual holds "**securities**" in a company - i.e. loan notes or debentures - these will only **qualify** for business property relief if the donor **controls the company**. To control a company, the donor must have more than 50% of the voting rights. This usually means the donor must own more than 50% of the ordinary shares.

Note that a "security" in this instance must be properly documented, commercial, marketable loan stock. Securities for BPR purposes will not therefore include directors loan accounts.

If a donor controls a company and also has loan stock in the company, the loan stock will qualify for BPR. The rate of BPR on securities/loan stock is **50%** if the company is **quoted** and **100%** if the company is **unquoted**.

7.5 Ownership requirements

(i) General rule

The general rule in Section 106 is that the donor must have owned the property for at least **2 years** before the transfer. If this minimum ownership requirement has not been satisfied, the donor will not receive BPR on the transfer. It is therefore very important to make sure that the donor has owned the assets for at least 2 years before he makes the gift.

[IHTA 1984,
s.106](#)

There are exceptions to the general rule in Section 107 through to Section 109, which we will look at next.

(ii) Section 107 IHTA 1984

[IHTA 1984,
s.107](#)

Section 107 allows BPR where "old" business property has been sold and **replaced with "new" business property**. If a donor sells business property and replaces it with other business property within 3 years, BPR will be available if the replacement asset is subsequently transferred.

BPR is given on the replacement property if the **aggregated ownership periods** - i.e. the period of time during which both the old and new property has been owned - **totals at least two of the five years immediately preceding the transfer**.

However, the BPR on the **replacement** asset cannot exceed the BPR that would have been available had the **original asset been retained**.

Illustration 1

Wilfred owned shares in an unquoted trading company (XYZ Ltd) between 2003 and 2008. Wilfred sold these shares for £100,000 in 2008. In August 2009, Wilfred reinvested the proceeds by buying shares in ABC Ltd for £120,000. In March 2011, Wilfred gave his shares in ABC Ltd to a discretionary trust when they were worth £130,000.

Under general principles, Wilfred will not receive BPR on his transfer of the ABC Ltd shares. Wilfred has only owned the ABC Ltd shares for about 18 months, so his minimum ownership period has not been satisfied.

However under Section 107, the ABC Ltd shares are "replacement property" and the proceeds from the original shares have been reinvested within three years. If we combine the ownership period of the two lots of shares, these total more than two out of the five years before the gift in March 2011. Therefore BPR will be given on the transfer of the ABC Ltd shares at a rate of 100%.

The next question is, 100% of what?

When the replacement rules apply, the rules state that the BPR shall not exceed

[IHTA 1984,
s. 108](#)

the BPR that would have been available had the original property not been replaced. This appears to suggest that the BPR on the transfer of the ABC Ltd shares is restricted to £100,000.

However, HMRC will take a practical approach to the maximum BPR given in this instance. They will therefore allow an adjustment to reflect the value of any growth in the replacement shares. Thus if the ABC shares have increased in value by (say) 10%, they will allow BPR on £100,000 plus 10%, ie £110,000.

(iii) Section 108 IHTA 1984

Section 108 deals with gifts of business property. Generally speaking, if a donor gives business assets to a donee, the donee's ownership period for BPR purposes will start at the date of the gift. However, a **donor's period of ownership can be aggregated with the donee's period if the transfer was between spouses on death.**

Illustration 2

Colin owns shares in an unlisted trading company. He gives shares to Diane, and Diane holds the shares for less than two years before transferring them to a discretionary trust. Normally no business property relief will be available on the transfer as Diane has not held the shares for two years.

However, Section 108 allows the periods to be aggregated if the donor and the donee are married, **and** the transfer by the donor to the donee was made on death.

Therefore in the above example, if Colin and Diane were husband and wife, and Colin transferred the shares to Diane via his Will, we could aggregate the ownership periods and Diane would get BPR on the transfer to the discretionary trust. This assumes that Colin and Diane's combined ownership period exceeds the minimum two years. **This is the only time that the ownership period of the donor and the donee can be added together.**

(iv) Section 109 IHTA 1984

[IHTA 1984,
s. 109](#)

Section 109 deals with **successive transfers in a two year period**. In the case of successive transfers:

- (a) if the **earlier transfer qualified** for business property relief, **and**
- (b) **either** of the two transfers was made **on death**,

business property relief will be given on the later transfer regardless of the ownership period.

Illustration 3

Eric owned shares in an unquoted trading company which were transferred to Fred on Eric's death. Fred holds the shares for less than two years before transferring them to a discretionary trust. Under general principles, Fred will not get BPR on the transfer as he had owned the shares for less than two years.

However S.109 will apply here. There have been two successive transfers in the two year period. Assuming Eric had owned the shares for more than two years before transferring them to Fred, this earlier transfer would have qualified for BPR. As at least one of the two transfers was made on death, S.109 will allow business property relief to reduce the second gift - i.e., by Fred to the discretionary trust.

7.6 Contracts for sale

[IHTA 1984,
s. 113](#)

If there is a **binding contract for the sale** of the asset in existence at the date of the transfer, HMRC will **deny any business property relief**. For example, if a vendor has entered into a contract to sell the asset but he subsequently dies before the sale is completed, no business property relief will be available in his death estate.

HMRC issued a Statement of Practice (SP 12/80) which highlighted a potential problem with partnership agreements.

[SP12/80](#)

Under a typical **partnership agreement**, there is usually a clause which says that on the **death** of any one of the partners, his partnership **share should be sold to his fellow partners**. In HMRC's opinion this constitutes a binding contract for sale, which means that no business property relief will be available on the transfer of a partnership interest, either during life or on death.

This problem is resolved by the **use of cross options**. Therefore instead of including a "buy and sell" clause within the partnership agreement, each partner will have an option whereby he has the right to sell his partnership interest to his fellow partners.

PR 19.9.84

Similarly the remaining partners have an option whereby they may buy back the share of a partner who has died. HMRC have confirmed that such an option is not a binding contract, and therefore there is no restriction in the business property relief.

The same issues apply in relation to shareholders agreements dealing with transfers of shares in companies.

7.7 Excepted assets

[IHTA 1984,
s. 112](#)

Business property relief will be restricted on a transfer of shares if the company holds **"excepted assets" on its balance sheet**. An "excepted asset"

for IHT purposes is an asset that is **not used for business purposes throughout the two years immediately preceding a transfer**. An asset is also an excepted asset if it is **not required for future use in the business**.

Excepted assets will typically include shares or securities held for investment purposes, or properties which are let out and produce rental income. It could also cover large cash deposits held for investment purposes and not required for future use in the business. The amount of the transfer qualifying for business property relief is the value of the shares gifted multiplied by the fraction below:

$$\text{Qualifying transfer} = \text{Gift} \times \frac{\text{Total assets} - \text{Excepted assets}}{\text{Total assets}}$$

Therefore if the company has no excepted assets, all of the value of the shares will qualify for BPR.

Illustration 4

George transfers shares (a 5% holding) in an unquoted trading company to a discretionary trust. The transfer of value (the loss to donor) is £100,000.

The balance sheet of the company at the date of the transfer is as below:

Balance sheet at gift:	£
Factory	900,000
Goodwill	500,000
Machinery	300,000
Investments	200,000
Let property	50,000
Cash (needed for business)	30,000
Stock	<u>20,000</u>
	<u>£2,000,000</u>

The company is worth £2 million. We need to identify any excepted assets on the balance sheet.

The investments of £200,000 will be excepted assets as they are not being used in the business. Similarly, the let property is also an excepted asset as it generates rental income rather than income trading profits.

The company therefore has total excepted assets of £250,000.

As George has transferred relevant business property to a discretionary trust, he will receive business property relief. The rate of BPR applying to shares in unquoted trading companies is 100%. However we need to multiply the value of the shares by the fraction:

$$\frac{\text{Total assets} - \text{Excepted assets}}{\text{Total assets}}$$

Total assets are £2 million and excepted assets are £250,000, so the BPR available on the transfer is £87,500.

	£
Shares transferred	100,000
Less: BPR	
£100,000 x [$\frac{2m - 250,000}{2m}$]	<u>(87,500)</u>
Transfer of value	12,500
Less: AEs x 2	<u>(6,000)</u>
CLT	<u>£6,500</u>

7.8 What is a trade or business for BPR?

S.105(3) denies BPR where the business "consists wholly or mainly of dealing in securities, stocks or shares, land or buildings or holding investments...". The case of *Martin & Horsfall v CIR* established that the letting of land did not qualify for BPR, but what of businesses where only part of their activities involve the letting of land and part involves a genuine trade? How do HMRC apply the "wholly or mainly" test in S.105(3)?

In *Hall's Executors v CIR* (1997) the Special Commissioners held that a caravan park business did not qualify for BPR as 84% of the income from the business was generated by rents from the chalets within the park. This principle was upheld in *Weston's Executors v CIR* (2000) where fees from the sale of caravans were held to be ancillary to the rental income deriving from pitch fees. The business was essentially one of letting rather than of caravan sales and BPR was again denied under S.105(3). Since *Weston*, HMRC has taken a quantitative approach and broadly if more than 50% of the income generated by a business derives from non-trading income, BPR is likely to be denied.

If "investment" income makes up less than half of total income, it is more likely that the business will not fall foul of s.105(3). However remember that if a business holds "excepted assets" on its Balance Sheet, BPR will be allowed in a restricted form under S.112.

However, since *Weston* a couple of cases have blurred the edges of this quantitative approach. In *Farmer v CIR*, the Special Commissioners held that the letting out of surplus land on a farm did not jeopardise BPR as

"the overall context of the business...supported the conclusion that the business consisted mainly of farming".

The fact that the lettings were more profitable than the rest of the actual farming business was not held to be conclusive and BPR was allowed.

Also in *George & Loochin v CIR* (2003), the Court of Appeal allowed BPR on shares in an unquoted trading company which owned and ran a residential caravan park. The company was classed as trading for corporation tax purposes, it had

several employees and most (72%) of its site fees were spent on overheads relating to the common parts of the park (including the country club and licensed bar on site). This was held to be the "provision of services" and not the holding of investments, so BPR was given.

In applying S.105(3), HMRC will look at the facts and circumstances of each case to determine whether BPR should be wholly denied. Thereafter HMRC may seek to restrict BPR under the excepted assets rules in S.112.

7.9 What is an "excepted asset" under s.112?

S.112 IHTA restricts BPR on a transfer of shares where the company has "excepted assets" on its balance sheet.

An "excepted asset" is one which is neither used wholly or mainly for trading purposes nor is required at the time for future use in the business.

In *Barclays Bank Trust Co Ltd v CIR* (1998), a taxpayer died owning shares in an unquoted trading company dealing in kitchen and bathroom fittings. The company had substantial cash reserves (£450,000) on its Balance Sheet. HMRC contended that this was an "excepted asset" as it was not required for future use in the business.

Despite evidence put forward by the Executors of the deceased that the funds were in fact later used to purchase stock, the Special Commissioners agreed with HMRC and held that the cash was not required for business use at the date of death. At that time the funds had not been earmarked for "some palpable business purpose" so BPR was subsequently restricted.

Example 1

Harry transferred a building to a discretionary trust in February 2011. It was worth £500,000. It was used by Harry Ltd, a company in which Harry owns 95% of the shares.

Harry's only previous transfer had been £128,000 in cash to the same trust in January 2009.

Calculate the IHT payable by the trustees on the 2010 gift.

Example 2

Carl owns the following assets.

Which of them are "relevant business property" for IHT purposes?

	Yes	No
(a) 5% holding of shares in ICI plc	✓	X
(b) 60% holding of shares in Boots plc		
(c) 2% holding of shares in Tolley Ltd		
(d) £100,000 of loan stock in Boots plc		
(e) Office building used by Tolley Ltd		

Answer 1

- (i) Gift to discretionary trust (January 2010)

	£
Gift	128,000
Less: AE 2009/10	(3,000)
Less: AE 2008/09	<u>(3,000)</u>
CLT	<u>122,000</u>
No tax as < nil band	

- (ii) Gift to discretionary trust (February 2011)

	£	£
Gift		500,000
Less: BPR @ 50%		<u>(250,000)</u>
		250,000
Less: AE 2010/11		<u>(3,000)</u>
CLT		247,000
Nil band	325,000	
Less: chargeable transfers in previous 7 years	<u>(122,000)</u>	
Nil band remaining		<u>(203,000)</u>
Taxable		<u>44,000</u>
IHT @ 20% (paid by trustees)		<u>£8,800</u>

Answer 2

	<i>Relevant business property?</i>		
	Yes	No	
a) 5% holding in ICI plc		X	(No control)
b) 60% holding in Boots plc	✓		(> 50%)
c) 2% holding in Tolley Ltd	✓		(Any number)
d) £100,000 Boots Loan Stock	✓		(Controls co. = 50% BPR)
e) Office building used by Tolley Ltd		X	(No control of company)