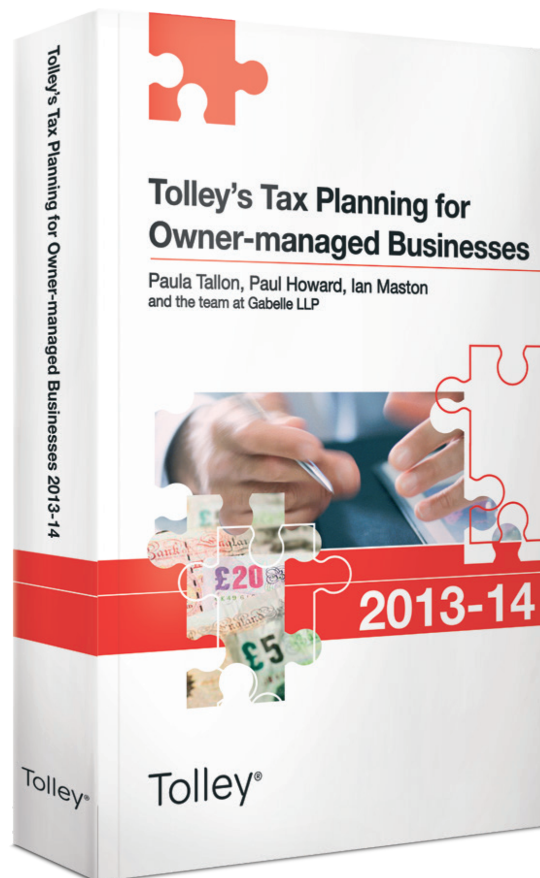
TOLLEY'S TAX PLANNING FOR OWNER-MANAGED BUSINESSES 2013-14

Entrepreneur's Relief and Business Property Relief chapter



To order a copy of
Tolley's Tax Planning for Owner-Managed Businesses 2013-14
visit **www.lexisnexis.co.uk**
or call **0845 3701234**

Tolley®

Tax intelligence
from LexisNexis®

Chapter 3

Entrepreneurs' Relief, and Business Property Relief

Introduction

[3.1]

Entrepreneurs' relief (ER) and business property relief (BPR) provide very valuable reliefs to the owners of businesses on the transfer of assets. Interestingly, the reliefs are very different, with their own unique set of rules. For advisers there is very often the conflict of preserving one relief while losing the other. If embarking on any planning for clients aimed at utilising these reliefs it is important to understand the clients' objectives. A client wishing to pass his business to his sons on death will not thank his adviser if the adviser has helped obtain ER but in the process loses BPR on part of the business. This chapter will examine both types of relief and will look at the planning and the pitfalls. It highlights the need to look at both reliefs together. There is a table summarising the reliefs at the end of the chapter which is a useful guide for the adviser.

The Institute of Chartered Accountants in England and Wales (ICAEW) published TAXGUIDE 1/12 on 25 January 2012 which is a guidance note (Note) containing practical points on ER. The guidance is agreed with HMRC and includes technical questions to which HMRC has provided answers. Some of the more important and interesting technical points have been included below.

Entrepreneurs’ relief (ER)

[3.2]

ER applies to qualifying business disposals after 5 April 2008. Full legislative provisions are contained in TCGA 1992, ss 169H–169S. The relief is such that the first £10 million (£5 million pre-6 April 2011) of gains arising on the disposal of qualifying business assets are charged to tax at 10%. For disposals made before 22 June 2010, ER had previously been given by reducing the otherwise assessable gain by 4/9ths.

Qualifying business disposals

[3.3]

ER is available for qualifying business disposals which are:

- a material disposal of business assets;
- a disposal of trust business assets;
- a disposal associated with a relevant material disposal.

Material disposal of business assets

[3.4]

Within this there are two criteria which need to be met; ‘material’ and ‘disposal of business assets’.

It makes sense to first look at the meaning of a disposal of business assets — it must be one of the following:

- a disposal of the whole or part of a business (this would exclude the disposal of individual assets unless the asset qualified as a going concern or business in its own right);

- a disposal of assets which were used for the purposes of a business which has since ceased but the assets must have been used in the business at the date of cessation (the disposal of an interest in such assets also qualifies);
- a disposal of shares or securities in a company (or an interest in shares or securities).

Whether the disposal is material depends on what is being sold. For the sale of the whole or part of a business the individual must have owned the business throughout the year leading up to the date of disposal.

Whether a disposal amounts to a part disposal of a business for the purposes of ER, or a sale of assets, has been considered in the case of *Mr Gilbert t/a United Foods v HMRC* [2011] UKFTT 705 (TC) at the First-tier Tribunal.

The FTT found that there were several indicators that part of the business was disposed of as a going concern.

- HMRC's manual at CG64015 is clear that a sale of a business as a going concern is a disposal of a business and the FTT could not see how this would not apply to part of a business;
- In the notes to the 2008 Finance Bill it says that the sale of a whole or part of the business must be as a going concern;
- In the retirement relief case of *Pepper v Daffurn 66 TC 88*, Jonathan Parker J held that a sale as a going concern is a sufficient but not necessary condition for the availability of the relief and this could extend to ER.

The tribunal found that the part of the business sold constituted a going concern as there was a disposal of both goodwill and a customer database. The FTT also considered HMRC's other assertion that there had to be a sale of a separate identifiable part of the business. Would a purchaser be able to carry of the business using only the assets transferred to it and the FTT agreed that it would. The taxpayer was successful in his appeal.

[3.5]

For the disposal of assets of a business which has ceased the individual must have owned the business for one year immediately preceding the cessation and the disposal of the assets must take place within three years of cessation.

A question was raised in ICAEW's Note whether assets that are disposed of after the cessation of the trade qualify for ER. HMRC's opinion is that where the business trade is carried on after the contract for disposing of assets has been made, it will still be possible to claim ER provided the business disposal is linked to the business cessation.

[3.6]

For the disposal of shares or securities the individual must meet one of the following conditions:

Condition A

[3.7]

Throughout the year immediately preceding the disposal, the following conditions should be met:

- The company must have been the individual's personal company. A personal company is one in which the individual holds at least 5% of the ordinary share capital of the company and that holding gives him at least 5% of the votes; and
- The company must be a trading company or the holding company of a trading group; and
- The individual must be an officer or employee of the company (or of companies that are members of the same trading group).

For these purposes, non-voting preference shares with a variable rate of dividend, count as ordinary shares. Even though these shares will not qualify for ER in their own right, because they are non-voting, other shareholders could be diluted below the 5% threshold.

Regarding the minimum 5% share capital threshold in a personal company, HMRC has stated in the ICAEW's Note that if a shareholder's ownership drops below the 5% threshold due to holders of share options exercising their rights on the same day just before the sale of the business takes place, then this will not result in the shareholder being ineligible for claiming ER provided the other qualifying conditions are met during the qualifying period.

HMRC has also confirmed that it is the nominal value of ordinary shares that must be considered regarding the 5% test, not the number of ordinary shares issued and there is no minimum disposal that constitutes as a material disposal.

Planning point

In cases where a company is sold and the shareholders receive shares in another company (AN Ltd) there is always a concern for ER. If the vendor receives 5% of the shares in AN Ltd how can he guarantee that he will not be diluted in the future thereby losing ER? One solution is for AN Ltd to create a new class of shares ('A' ordinary shares) that carry the right to rank pari passu with the existing shares but have no right to receive dividends and only have a right to receive proceeds on a winding up or on a sale of AN Ltd up to par value. These shares could then be used to ensure that the 5% test is met.

Condition B

[3.8]

Where the company has ceased to trade and all the conditions in A above were met for the year leading up to cessation, relief will be available for disposals made within three years ending with the date of disposal.

Planning point

Where shares are held jointly by a husband and wife each is treated as having a 50% interest in looking at the personal company test. For example, if together a married couple hold 8% of the shares they are treated as holding 4% each in determining whether the 5% test is met. In this case neither would meet the personal company test. It would be beneficial for the couple to change their beneficial interests so at least the 5% test would be met by one party. The new arrangements would need to be in place one year before the benefit of ER is available.

A more efficient alternative is for one spouse to hold all the shares especially with the £10 million ER limit.

Planning point

In a husband and wife situation where both meet the 5% test but only one works in the business you could consider transferring the shares to the working spouse. The transferee spouse does not have to wait one year to dispose of the shares as the conditions above were met in respect of his existing shares. This means that this type of planning can be carried out shortly before a sale. For the vendors it's the difference between 28% and 10% tax so always worth considering.

Trading company

[3.9]

A trading company for the purposes of ER is defined in TCGA 1992, s 165A as 'a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities'.

Trading activities include:

> ‘activities carried on by the company:
>
> (a) in the course of, or for the purposes of, a trade being carried on by it,
>
> (b) for the purposes of a trade that it is preparing to carry on,
>
> (c) with a view to its acquiring or starting to carry on a trade, or
>
> (d) with a view to its acquiring a significant interest in the share capital of another company that:
>
> (i) is a trading company or the holding company of a trading group, and
>
> (ii) if the acquiring company is a member of a group of companies, it is not a member of that group.’

Activities in (b) and (c) are only qualifying activities if the company starts to carry on the trade as soon as is reasonably practicable. There is no statutory definition of what is meant by ‘as soon as is reasonably practicable’ but HMRC's manual at CG64075 states:

‘Rather than impose a fixed time limit, the legislation allows companies whatever time is reasonable, having regard to the particular circumstances, to prepare to carry on a new trade or to acquire a trade or trading company. What is “reasonably practicable in the circumstances” will depend on the facts in each case. For example, a company may be in negotiations to acquire a trading company but owing to circumstances beyond its control the purchase is delayed. There might be, for example, a problem with the vendor proving title to the company's assets. Where this was the reason for the delay we would not suggest that the acquisition had not been made as soon as was reasonably practicable in the circumstances.’

In looking at a group, a trading group (TCGA 1992, s 165A(8)) is a:

> group of companies:
>
> (a) one or more of whose members carry on trading activities, and
>
> (b) the activities of whose members when taken together do not include substantial non-trading activities.

Members of the group are any 51% subsidiaries. Where shareholdings in other companies are 50% or less, they could result in the company having investments, unless the shareholdings qualify as joint ventures.

A qualifying shareholding in a joint venture company is one which is more than 10% and:

- in a company which is a trading company or the holding company of a trading group; and
- 75% or more of the ordinary share capital in the company is held by no more than five persons.

For ER planning purposes this joint venture definition proves very useful.

Planning point

Where a company has a number of employees who hold shares it is unlikely that these employees will have 5% each so ER is not available to them. Take a situation where there are five employees each holding 3%, none of them qualify for ER. However, if the employees were to hold that combined 15% in a limited company (Newco) and they each hold 20% of Newco, the situation changes; the shares now qualify for ER. The Newco holds 10% of the original company making the latter a qualifying joint venture company. The CGT rate for these employees is now 10% instead of 28% with some very simple planning.

For existing structures, the tax implications arising from interposing a new holding company to achieve this result need to be considered carefully taking into account the rules on transactions in securities covered in Chapter 14.

For shares acquired from the exercise of EMI options the ER rules have been relaxed. Where shares are acquired under an EMI option and disposed of after 5 April 2013 the 12 month qualifying period for ER

will start from the date the options were granted. Also there is no requirement for the holder of the shares to meet the 5% holding test. These changes make it easier for employee shareholders to benefit from ER. A company will not be a trading company if it has substantial non-trading activities. HMRC confirmed in Tax Bulletin 53 (TB 53) that substantial means 20%. Therefore, if a company has investments or other assets not used in the trade, these could disqualify the company as a trading company. In TB 53, HMRC gave guidance on how the 20% should be measured illustrating three bases of measurement.

Turnover from non-trading activities

[3.10]

This examines the proportion of income from non-trading activities to that from trading activities. This is on a gross basis. For example, if there is interest arising on a bank account which holds cash not required for the business, this is compared to turnover. In the majority of cases, interest is unlikely to be more than 20%. Similarly, if the company has an investment property, the rental income should be compared to the turnover.

Expenses incurred by, or time spent by, officers and employees of the company in undertaking its activities

[3.11]

This examines the time spent by officers and employees of the company on non-trading activities. Whether it is a property on a long let or cash in a bank account, in most cases it is difficult to see how such activity could take up more than 20% of the directors' and employees' time. The same holds true for the expenses test.

Asset base of the company

[3.12]

For the majority of companies, this is the test that causes the most concern. Does the non-trading asset account for more than 20% of the company's assets? For an investment property the measurement will be relatively straight forward however if the non-business asset is cash this is not the case. This asset base test is considered later in relation to excess cash in the company.

These tests are a guideline and there is no requirement to meet three out of three. According to TB 53:

‘The historical context of the company may be relevant. For example, it is quite possible that at an instant in time certain receipts may not be insubstantial but, if looked at on a longer timescale, they may. Looking at the historical context therefore a company might be able to show that it was a trading company at a particular point in time.

It may be that some measures point in one direction and others in the opposite direction. We would weigh up the impact of each of the measures to balance the effects of measures that point in different directions in coming to a view.’

Advisers should remember that TB 53 is simply guidance. There may be other measures which are better suited to particular businesses, and advisers should not hesitate in using other measurements where these are appropriate.

Substantial cash in the company

[3.13]

One of the most common problems faced by advisers in relation to the trading company definition is large cash balances held by the company. With the prospect of a 10% tax rate, many owner-managers build up cash balances in the business in the hope that there will be an eventual exit and a 10% tax rate will be

available. This exit could be by way of a sale or perhaps a member's voluntary liquidation. Building high levels of cash in the business can be dangerous, because if cash is not required in the business and the amount is substantial, the company may not qualify as a trading company. The key issue is to determine what level of cash can be held in the business without a loss of ER. Remember for ER we are only concerned with a one year look back.

In deciding whether cash is excessive, the key measure is going to be the asset base of the company. It is unlikely that any interest is substantial in relation to turnover, and even if the director moved the money to a different bank account every day, it is unlikely to take up more than 20% of his time! Therefore, the practical basis of measurement is going to be against assets; what is the ratio of cash to the total assets? In calculating this ratio, it is back to basics and the use of a numerator and denominator test:

$$\frac{N}{D}$$

Where:

N = the excess cash in the company.

D = the total assets of the company.

This must be less than 20%.

Numerator

[3.14]

The first point to remember is that it is only the excess cash that should be measured, not the total cash in the business. Therefore, any cash needed in the company should be excluded from the test. There are three main reasons why cash is needed in a company:

Working capital requirement — every business needs cash to finance its day-to-day activities. One way of looking at this is to work out the liquidity ratios for the company. These will provide information about the company's ability to meet its short-term financial obligations. The most common ratio is:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

There could be a situation where the company has debtors who can control its trading, eg blue-chip companies, and creditors who can also control their credit terms. The company could find itself in a situation where it is waiting for money from a debtor and the creditor calls in its debts. To work out what cash would be required, the cash ratio could be used, as this is an indication of the company's ability to pay off its current liabilities if for some reason immediate payment were demanded:

$$\text{Cash ratio} = \frac{\text{Cash} + \text{marketable securities}}{\text{Current liabilities}}$$

For many owner-managed companies, this can pose a high risk.

Precautionary — all companies need a buffer of cash in their business for contingencies. While for many starter businesses the idea of contingent cash is a luxury, for established businesses it makes good commercial sense. Precautionary reasons include the reliance on a large contract, a possible downturn in the particular industry sector, a breakdown of machinery, a loss of key employees or anything else which poses a real threat to the company.

Future plans — a growing business will always want cash reserves to deal with future expansion plans. This could include the acquisition of a new property or new equipment. It is reasonable that a company would work towards building up a cash reserve for these purposes.

Whatever the reasons for holding cash in the business, it is important that these are documented. Even for very small family-run companies, HMRC places great reliance on board minutes. Any high levels of

cash in the business should be discussed and considered and the reasons for holding the cash balances documented in regular board minutes. Detailed notes on the management accounts are also very helpful. The company should have evidence to back up its reasons for holding excess cash, and this should be maintained on an ongoing basis.

Having established what cash is required for the business, this should be deducted from the cash balance. It is this net figure which is used as 'N' in the above formula.

Denominator

[3.15]

This looks at the total assets in the company and will usually be taken from the balance sheet. For the assets on the balance sheet, these should be adjusted to their market value. So, for the property that has not been revalued in a while, the market value should be obtained. Perhaps more importantly, many owner-managed businesses will not have goodwill on their balance sheet. However, if there is a sale of the business, the consideration is likely to be more than the net assets of the business. This means that there must be some goodwill in the business. This goodwill did not suddenly appear on the day of sale, it has been accumulating since the business started. So, in looking at the assets of the company, the value of goodwill should be included irrespective of the fact it is off balance sheet, because it is internally generated. This adjusted gross-asset figure should be included as 'D' in the above formula.

Although HMRC appears to have a relaxed approach to cash in the company the following guidance is contained in CG64060:

'However, the long term retention of significant earnings generated from trading activities may amount to an investment activity. The first point to consider is whether or not there is any identifiable activity distinct from the trading activity.

Factors to consider include:

- whether the earnings are retained for the present and future cash flow requirements of the trading activity.
- the nature of the underlying investments used as a lodgement for the funds, for instance if the funds are locked into long term investments or the investments themselves are high risk that may suggest that they are not available for the trading activity.
- the extent of the company's (or group's) activity in managing the investments.
- whether the funds have been ear-marked for a particular use in the trading activity.

If a separate investment activity is identified then it will become necessary to determine whether that is substantial in terms of the overall activities.'

In practice where a company or group has cash which has been generated from its trading activities and a reasonable salary/dividend is extracted from the company HMRC would not seek to argue the ER position. Where large amounts of cash are retained in the business and there is a business purpose for this it is prudent to record the reasons and decisions in board minutes and other contemporaneous correspondence.

Qualifying business disposals by trustees

[3.16]

A trust is not entitled to ER instead it relies on using the ER qualifying status of a beneficiary. ER is available on the disposal of trust assets where all the following conditions are satisfied:

(1) the trustees dispose of settlement business assets. These are assets (or an interest in assets) which have been used for the purposes of a business or shares or securities in a company;

(2) an individual is a qualifying beneficiary in the settlement. A qualifying beneficiary is one who has an interest in possession (but not for a fixed term) in the whole of the settlement or the part that contains the business assets which have been disposed.

(3) If the business assets are shares or securities the personal company conditions must be met by reference to the qualifying beneficiary's holding of shares and that individual must be an officer or employee of the company (or a group company). These conditions must be met throughout a period of one year ending within the three years prior to the disposal. For the 5% test the beneficiary must meet this in his own right irrespective of what shares the trust holds.

(4) Where the assets disposed are assets used in a business these must have been used by the qualifying beneficiary in a business carried on throughout a period of one year ending not earlier than three years before the date of the disposal and the beneficiary ceases to carry on the business at that time or ending three years before.

Point (4) indicates that the timing provision for trustees is more flexible and may be applied for a wider time frame. HMRC’s view regarding the matter is that trustees may not have the same scope to determine when they dispose of their business assets as individuals would.

[3.17]

Any references to an individual carrying on a business include references to where the beneficiary is a member of a partnership and the references to ceasing in business include the beneficiary ceasing as a partner or the partnership ceasing to carry on in business.

When calculating the total ER available to the trustees and any qualifying beneficiaries the £10m limit on gains is effectively shared (ss 169N(3)(7) and 169O). Trusts do not have their own ER limit; they are effectively given some of the beneficiary's limit subject to the trustees and the beneficiary making a joint election.

Qualifying associated disposals

[3.18]

An associated disposal is the disposal of an asset owned by an individual and used for the purposes of a business carried on by a partnership in which the individual is a partner or a company which is the individual's personal company. A sole trader cannot have an associated disposal. Again there are some conditions to be met which are covered in s 169K.

(A) The individual must dispose of all or part of his interest in the assets of a partnership or of shares or securities in a company which qualifies as a material disposal of business assets.

(B) The disposal must be made as part of a withdrawal process from the business.

(C) The assets must have been used for the purposes of the partnership business or company business throughout the period of one year ending with the disposal of the business or the cessation of the business if earlier.

A withdrawal from the business is not linked to the amount of work done or time spent working in the business which has been confirmed by HMRC in the Note. For instance, if the individual sold his shares and a property which the company used, for the purposes of its trade, this would constitute a withdrawal from the business. Further commentary and some examples can be found in HMRC's manuals at CG63995.

Planning point

Where an asset is sold after the cessation of the business there is no restriction on how the asset is used between the cessation of the business and the date of sale where this is within one year. However the asset must have been in use in the business right up to the date of cessation. This gives a window of opportunity to obtain some income on the property.

Where there is an interval between the material disposal and the disposal of the asset HMRC will allow the disposal to be an associated disposal if:

- the asset is disposed of within one year of the cessation of a business; or
- the asset is disposed of within three years of the cessation of a business and the asset has not been leased or used for any other purpose at any time after the business ceased;
- where the business has not ceased, the asset is disposed of within three years of the material disposal provided the asset has not been used for any purpose other than that of the business.

Difficulties in claiming ER for an associated disposal will arise where the asset is disposed of before the material disposal. Where however the timing of disposals is as a result of commercial problems encountered and there is a clearly recorded understanding that both an asset and material disposal were desired, a claim for relief may be accepted. In some situations an adjustment will be required. These are outlined at s 169P.

Issue	**Adjustment required**
Asset only used for the purpose of the business for only part of the time owned	Adjust for the period of non-business use
Only part of the asset used on the business	Adjust for the part not used in the business
Individual involved in carrying on the business for only part of the period (personally, as a partner or as an employee or officer)	Adjust for the period not involved in the business.
Where rent was paid for the use of the asset post 5 April 2008	If rent was at market value no ER available. If the rent was less than market value the following proportion gets ER: <u>MV rent – rent paid</u> MV rent

Partnerships

[3.19]

Special rules apply to ensure that ER can be claimed where an individual carries on business as a member of a partnership:

- where an individual carrying on a business takes on a partner a disposal of interests in business assets contributed to the partnership are treated as a disposal of part of the business;
- where a partner disposes of all or part of his interest in partnership assets the disposal can be treated as a disposal of the whole or part of the partnership business.

Claims for ER

[3.20]

To obtain ER a claim must be made by the first anniversary of the 31 January following the tax year in which the disposal is made. So for a disposal in 2011/12 the taxpayer has until 31 January 2014 to make a claim. For trust disposals the claim must be made jointly by the trustees and the qualifying beneficiary.

For a remittance basis user or a temporary non-UK resident, it is advisable to make a protective ER claim if a taxpayer has made a qualifying gain and there is a possibility that the gain will be remitted to the UK or that the taxpayer will return to the UK within four years of leaving. If the taxpayer has not made a

protective claim and the statutory deadline for an ER claim has passed the ER would be lost. The applicable ER limit is the one existing at the time the gain arises not when the gain is remitted to the UK.

In dealing with a claim for ER by a trust there is no specific method for the joint claim. A joint claim should accompany the trustees‟ tax return. However if the tax return is filed online the claim will have to be sent to the trustees' tax office separately. HMRC's Help Sheet 275 on ER contains a template claim which can be used for claims made jointly by the trustees and the qualifying beneficiary.

Where a trust ends due to the death of a beneficiary and the beneficiary met the conditions for ER, the representatives of the beneficiary can apply for ER.

Calculation of the relief

Step 1

[3.21]

Calculate the relevant gains. These are gains arising on a qualifying business disposal.

Step 2

Deduct any relevant losses. These are losses arising on a qualifying business disposal.

Step 3

The net figure arising from the above two steps is taxed at 10%.

Allowable losses and the annual exemption may be deducted from gains in such way as is most beneficial to that person (TCGA 1992, s 4B). This assists in maximising claims for ER.

In ICAEW's Note HMRC has commented on aggregation issues regarding the disposal of shares and business assets. HMRC's view is that there is no reason to apply aggregation to shares of one company that are disposed of in separate years, so the disposals will qualify as separate material disposals.

In the example in the Note where a taxpayer sold his business and disposed of all the assets except for one which was sold separately to a third party, HMRC has taken the view that the fact that one of the assets was sold to a third party is not sufficient to treat the disposals as separate. The taxpayer sold the business, so the disposals should be treated as part of one deal.

Over-Riding Limit

[3.22]

There is a lifetime limit of £10 million.

ER — Exchange for shares or loan notes on a takeover

[3.23]

Where there is a 'paper for paper' transaction there are specific rules for ER. If the shares being exchanged would have qualified for ER and any subsequent gain will not qualify as the personal company requirement will not be met, the taxpayer can make a claim that the share for share rules (TCGA 1992, s 127) do not apply. This means the gain comes into charge in the year of exchange with the benefit of ER.

The time limit for making such a claim is twelve months from 31 January following the tax year in which the exchange occurs.

Pre-23 June 2010 where the shares being exchanged would have qualified for ER and the exchange was for QCBs, the taxpayer could elect for ER and defer the tax until the QCBs were redeemed. From 23 June 2010 it is no longer possible to defer gains and claim ER. Vendors now have to choose between claiming ER and paying 10% in the year of sale or paying tax at 18% or 28% when the gain comes back into charge (TCGA 1992, s 169R).

Transitional rules

[3.24]

Transitional rules apply where there was an exchange of shares or securities for QCBs before 6 April 2008 but the gain is treated as arising after that date. If the disposal would have qualified for ER had ER been available the taxpayer can make a claim for ER to apply. This reduces the gain by 4/9ths. ER must be claimed on the first occasion after 6 April 2008 when any of the deferred gain comes into charge. For deferred gains which came partly into charge between 6 April 2008 and 22 June 2010, the remaining gain (which will have been reduced by 4/9ths) will be taxed at 18% or 28% thus giving an effective rate of 15.56% instead of 10% for those liable to higher rate tax. For deferred gains that have not come into charge before 22 June 2010 they will be taxed at 10% if an ER claim is made.

Furnished Holiday Lets (FHLs)

[3.25]

The ER legislation specifically provides for these to qualify for ER. The requirements for a FHL are set out in ITTOIA 2005, s 325. The criteria as to what qualifies changed from April 2012 – the availability of accommodation for letting as holiday accommodation and the actual letting of holiday accommodation during the relevant period (ITTOIA 2005, s 324) was increased to 210 and 105 days, respectively. From 2011/12 the losses are restricted to offset against the same trade.

Planning Point

For businesses operating FHL, the qualifying conditions for ER have to be satisfied in a one-year period prior to the disposal. There is no restriction in respect of non-qualifying periods as is required for associated disposals. Therefore, if a long-held investment property starts to be used on a holiday-let basis, for at least 12 months prior to disposal, a claim for ER can be made reducing the capital gain from a worse case 28% to 10%.

ER — Interaction with deferral reliefs

Enterprise Investment Scheme (EIS)

[3.26]

In calculating the amount of the gain which is deferred it is the gain after ER which can be deferred.

As with pre-6 April 2008 exchanges of shares for QCBs, where deferred gains which came partly into charge between 6 April 2008 and 22 June 2010, the remaining gain (which will have been reduced by 4/9ths) will be taxed at 18% or 28%. For deferred gains that have not come into charge before 22 June 2010 they will be taxed at 10% if the ER claim is made.

Incorporation relief (TCGA 1992, s 162)

[3.27]

When an individual transfers a business to a company in exchange for shares the gain arising on the disposal of assets is rolled into the base cost of the shares where certain conditions are met. This treatment is mandatory if the conditions in TCGA 1992, s 162 are met. The amount of the gain rolled into the base cost is the gain before ER. If an individual wants to claim ER on the incorporation of a business an election should be made under TCGA 1992, s 162A to disapply incorporation relief. This means that the assets are treated as being sold to the company at market value and the gain is calculated in the usual manner and ER is applied to arrive at the net gain. The date for making the claim to disapply TCGA 1992, s 162 is the second anniversary of the 31 January next following the year of assessment in which the transfer of the business takes place.

Business Asset Gift relief (TCGA 1992, s 165)

[3.28]

ER applies after any claim for holdover relief under TCGA 1992 s 165 or s 260. Given the difference in the time limit between making an ER and gift relief claim this may cause difficulties in practice with planning.

Roll-over relief (TCGA 1992, s 152)

Where an individual disposes of certain qualifying assets and spends the consideration on replacement assets any gain arising on the disposal can be rolled into the base cost of the new assets. ER is only available on any gain remaining after the application of roll-over relief.

BPR

[3.29]

For an owner-managed business, inheritance tax BPR is a most generous relief. It reduces the value for inheritance tax (on death or in relation to a lifetime transfer) of certain business assets by sometimes 50% but more usually 100%.

In describing how the relief applies, it is useful first to set out an overview of the principal rules.

First (contained in IHTA 1984, s 105(1)), there is a list of the *types* of business asset which *could* attract relief. If an individual owns an asset on that list, there is a *possibility*, subject to the following provisos, that it will attract relief. If an asset is not on the list, any claim for relief falls at the very first hurdle.

Further, it is the *type* of asset which then determines the rate of relief as either 50% or 100%.

Next, there is a requirement as to the *nature* of the business with *investment* businesses and certain other businesses being denied relief. There are special rules for groups of companies, the holding companies of which would otherwise be denied relief as *investment* businesses.

There are then a number of rules which, while not completely denying relief to a business, would operate to *restrict* the level of relief available.

There are positive requirements concerning requisite periods of ownership – usually two years but with a number of exemptions.

Finally, there are also negative requirements in that *binding contracts for sale* need to be avoided if relief is to be available. Likewise, *liquidations* and *winding-ups* can have the same effect.

Each of these elements is considered in detail below.

Qualifying types — 50% relief

[3.30]

50% relief (IHTA 1984, s 104(1)(b)) is available in relation to ‘any *land* or *building, machinery or plant* which, immediately before the transfer, was used wholly or mainly for the purposes of a business carried

on by a company of which the transferor then had control or by a partnership of which he was then a partner' (IHTA 1984, s 105(1)(d)). This is covered in more detail in Chapter 4. There is also a related rule providing 50% relief to 'any *land* or *building, machinery* or *plant* which, immediately before the transfer, was used wholly or mainly for the purposes of a business carried on by the transferor and was settled property in which he was then beneficially entitled to an interest in possession' (IHTA 1984, s 105(1)(e)).

50% relief is also available in respect of 'shares in or securities of a company which are *quoted* and which … gave the transferor *control* of the company …' (IHTA 1984, s 105(1)(cc). 'Quoted' in this context means listed on a recognised stock exchange (see further below). This category is, of course, of no relevance to the vast majority of owner-managed businesses.

Qualifying types — 100% relief

[3.31]

BPR is available at 100% in relation to property consisting of a business or interest in a business which is to say the assets of a sole trader or the partnership interest of a partner. (In this respect see also Chapter 15 and the commentary on the *Nelson Dance* case.)

100% relief is also available in relation to any unquoted shares in a company, where 'unquoted' means *not* listed on a recognised stock exchange and which therefore includes shares listed on the Alternative Investment Market (AIM) or the OFEX or Euro Nasdaq markets and, more importantly, private company shares. It is important to note that the relief applies to *all* unquoted shares, regardless of the size of the holding and regardless of the rights attaching to the shares.

Finally, 100% relief is also available to 'securities' in a company that contribute towards the holder's control of the company (this is discussed further in Chapter 12 in relation to the incorporation of a business).

The required 'nature' of the business: 1 — the desire for gain

[3.32]

To qualify for relief, the business carried on by the sole trader, partner or by the company *can be* a business carried on in the exercise of a profession or vocation, but it *cannot be* a business carried on *otherwise than for a gain*.

Thus, a business carried on only with the intention of attracting BPR but with no intention to make a commercial return would be denied relief. Likewise, the authors have advised in cases concerning businesses that have been run for many years at a loss – more as a 'hobby' rather than a commercial enterprise – and these too should not qualify.

These situations need to be contrasted with the case of a business which is carried on with a view to making a commercial return but which is struggling and which therefore has a history of loss-making. Such a business should nevertheless fall within the definition of a business carried on '*for* a gain', even if none is actually being made.

The required 'nature' of the business: 2 — prohibited businesses

[3.33]

BPR is specifically denied in relation to businesses consisting *wholly or mainly* of one or more of the following:

- dealing in securities, stock or shares (subject to certain exemptions concerning 'market makers' and discount houses) (IHTA 1984, ss 105(4)(a) and 105(7));
- dealing in land or buildings; or
- making or holding investments (IHTA 1984, s 105(3)).

The Special Commissioners case of *Piercy (executors of, decd) v Revenue and Customs Comrs* [2008] SWTI 1647 contains a useful statement on the distinction between a land dealing company and a property development company in this context;

> '… a company whose business it is to acquire land with a view to promoting a development, and then realising the developed land once sub-contracted building work has been completed, is also not a "land dealing company"…The only type of land dealing company whose shares fail to qualify for relief is thus some sort of dealing or speculative trader that does not actively develop or actually build on land…'

It is the third of the above exclusions which is the most fundamental and far-reaching because it denies relief to all 'wholly or mainly' *investment* businesses.

When considering the application of this rule in practice, two important questions arise:

(1) What is meant by 'investment' in this context?

(2) How is the 'wholly and mainly' test to be applied?

The required 'nature' of the business: 3 — the meaning of 'investment'

[3.34]

In recent years, a number of cases (mainly before the Special Commissioners) have tested what is meant by an 'investment' business.

In *Cook (Inspector of Taxes) v Medway Housing Society Ltd* [1997] STC 90, – a case not directly connected with BPR – Lightman J defined 'investment' as 'the laying out of money in anticipation of a profitable capital or income return', and this broad definition has been applied in a number of these BPR cases.

The holding of a portfolio of stocks and shares or an interest-bearing bank account would, prima facie, constitute 'investment' activities. The key element that has, in addition, emerged from the cases is that *holding land or property in anticipation of a 'rental' income* of some sort is also invariably considered to be an 'investment' activity by the Commissioners or the Courts. The decision of the Northern Ireland Court of Appeal in *McCall (Philip Norman) and Keenan (Bernard Joseph) (personal representatives of McClean (Eileen), (dec'd)) v Revenue and Customs Comrs* [2009] NICA 12, [2009] STC 990 illustrates this very clearly.

Beyond those clear-cut limits, however, it has proved difficult for HMRC to establish that a particular activity should be considered one of 'investment'.

In the case of *IRC v George* [2003] EWHC 318 (Ch), [2003] STC 468, for example, the Court of Appeal ultimately rejected HMRC's argument that services provided (eg gas, water, electricity) ancillary to a business of renting caravans should also be considered as part of the 'investment' business.

In the more recent case of *Phillips (executors of Phillips, decd) v Revenue and Customs Comrs* (SpC 555) [2006] STC (SCD) 639, a company whose balance sheet consisted almost entirely of loan creditors qualified for relief because the Special Commissioner did not consider that the making of loans in these circumstances constituted the making or holding of investments.

The following list provides a quick summary of the application of the BPR rules in relation to a number of land and property based businesses.

- A property *dealing* business is specifically denied relief.
- A property *letting* company would not qualify as a result of the 'investment' proviso.
- A property *development* company would qualify because development is not 'investment'.

- A company operating a hotel or B&B would usually qualify because although, in one sense, it is letting land, the income comes from the provision of a much wider array of services than simply provision of land in anticipation of a 'rent'.

The position in relation to 'furnished holiday lets' has been subject to a relatively recent change in HMRC practice. Earlier versions of HMRC manuals stated:

> The HMRC Solicitor has advised the office that in some instances the distinction between a business of furnished holiday lettings and say, a business running a hotel or a motel may be so minimal that the Courts would not regard such a business as one of "wholly or mainly holding investments" for the purposes of IHTA84/s105 (3).

The latest version (at IHTM 25278) states:

> In the past we have thought that business property relief would normally be available where:
>
> - The lettings were short-term
> - The owner – either himself or through an agent such as a relative was substantially involved with the holidaymaker(s) in terms of their activities on and from the premises.
>
> Recent advice from Solicitor's Office has caused us to reconsider our approach and it may well be that some cases that might have previously qualified should not have done so, In particular, we will be looking more closely at the level and type of services, rather than who provided them.'

At this point in the previous edition of this book we stated as follows:

'In the author's view, it is likely to be difficult going forward – bearing in mind the *Farmer* criteria mentioned below – to persuade HMRC that the level and type of service provided with a furnished holiday let is such as to make it a "mainly" trading rather than investment business. In particular, it is considered that significantly more services than would typically be provided to a holiday-maker in a furnished holiday let will be required.'

This has proved to be the case to the extent that HMRC has now taken a case. In *Mrs M V Pawson (Deceased) v HMRC* [UKUT 050 (TCC)], decided in the Upper tribunal on 28 January 2013 (and reversing the First-tier decision) the BPR claim was rejected in relation to a furnished holiday letting where only the most basic services were provided to the holiday makers.

In overturning the decision of the First-tier tribunal Mr Justice Henderson concluded that the "standard nature" of the services were "all aimed at maximising the income". To be trading there would need to be a level of services that enhance the holiday experience rather than simply providing it i.e. akin to a hotel or bed and breakfast.

For a full discussion and facts of the *Pawson* case, see the authors' *Beside the seaside in Taxation*, 23 February 2012.

In the even more recent case of *Trustees of David Zetland Settlement v HMRC (TC02690)* decided on 17 May 2013, the First-tier tribunal relied upon the decision in *Pawson* to deny BPR to another land based business – that of a serviced office. Although the facts of the case were somewhat specific, the decision again turned on the fact that the business was *mainly* one of providing land in return for a rent and the level of service provided was insufficient to 'trump' this.

The 'wholly or mainly' test

[3.35]

BPR will be denied if a business is 'wholly or mainly' one of investment. Thus, a business which carries on both investment and trading activities will qualify for relief if it is 'mainly' not investment. In most cases, of course, if a business is not investment, it is trading and – although there is no positive requirement that a business has to be 'trading' to qualify for BPR – for ease of reference in the examples and commentary which follows, 'trading' is used instead of the more clumsy 'not investment'.

Quantitatively, the test is clear; it means more than 50%. Thus, a business which is 51% trading will attract relief, and a business which is 51% investment will attract no relief.

Qualitatively, the test is less clear, as there is no statutory guidance. It is unsurprising, therefore, that the question of how to apply the 'wholly or mainly' test has also been at the heart of a number of the important cases.

In the past, HMRC sought to place great emphasis upon net profitability as being the determining yardstick, so that only those businesses which generated less than 50% of their net profit from investment activities qualified for relief. This approach led to a detailed analysis of the source and nature of the income but also, and this was not always easy to determine, against which income the expenditure should be deducted.

By contrast, the Special Commissioners' decision in *Farmer (Executors of Farmer dec'd) v IRC* [1999] STC (SCD) 321 consolidated what has become known as the 'in the round' approach. The facts were that the deceased, who died in 1997, left a 449-acre working farm that included many properties which were surplus to the requirements of the farm and which were let to third parties. The executors claimed BPR on the let properties on the basis that there was a single business. The Special Commissioner stated as follows:

> 'It is now time to stand back and to consider the business in the round. Of the five relevant factors …
>
> - the overall context of the business;
> - the capital employed;
> - the time spent by the employees;
> - the turnover; and
> - the profit
>
> … four, namely, the overall context of the business, the capital employed, the time spent by the employees and consultants and the levels of turnover, all support the conclusion that the business consisted mainly of farming; the profit figures, and more particularly the net profit figures, on the other hand, support the opposite view. Taking the whole business in the round, and without giving predominance to any one factor, the conclusion is that the business consisted mainly of farming and not of making or holding investments.'

When considering the BPR position of a business with a mixture of trading and investment activities, it is usually helpful to consider the five elements set out in this case, and if, in relation to two or more elements, the trading activities predominate, there is at least the chance that HMRC may be persuaded to the view that the business is not, 'in the round', mainly an investment business (with, of course, the more trading elements the better). For a recent decision where these principles were applied in practice in favour of the taxpayer see the decision in the Upper Tribunal in the case of *Brander (representative of James (dec'd), Fourth Earl of Balfour) v Revenue and Comrs* [2010] UKUT 300 (TCC), [2010] STC 2666, 80 TC 163.

It should be emphasised that if the 'wholly or mainly' test is passed, the *entire value* of the business will potentially attract 100% relief. In other words, there is no automatic disqualification of relief in relation to the investment element of the business. Relief can be restricted only by the separate rules described below, and, as will be seen, these do not *automatically* apply to investments.

Holding companies and group structures

[3.36]

When considering the position of an individual holding shares in a company constituting part of a group, it is important to remember that *strictly* it is only the BPR position in relation to the company directly owned by the individual that needs to be considered.

Thus, if an individual owns shares in a company which is the holding company of a group, what has to be considered is whether that holding company qualifies for relief or not.

Of course, a pure holding company is itself an 'investment' company because it does little but hold shares in its subsidiaries (assuming that it carries on no trade itself). Were it not for the following special rule, all holding companies would be denied relief on the grounds set out above. IHTA 1984, s 105(4), provides that the requirement that the business had to be 'not investment' does not apply to:

- 'shares in or securities of a company if the business of the company consists wholly or mainly in being a holding company of one or more companies whose business does not fall within that [investment] definition.'

The concepts of a 'holding company', 'group' and 'subsidiary' have the same meanings as for other taxes (as described in Chapter 5), and it is particularly important to understand which companies strictly form part of a group in determining the BPR position, as the following examples demonstrate.

Example 1

Here, all the companies are part of one group. Company XYZ is 'wholly' the holding company of group companies, and, to the extent that the value of the two trading subsidiaries exceeds that of the investment company, it is mainly a trading group. Thus, BPR should be available in relation to Company XYZ (but see below as to the restriction on the relief that would apply).

Example 2

If we assume the same structure as in Example 1 but with, this time, Company (B) as an investment company, Company XYZ would still be wholly the holding company of a group, but now the group would be mainly one of investment, so no relief would apply.

Example 3

Finally, if we assume the same structure as in Example 1 but with, this time, the shareholdings in Companies (A) and (C) being 45% but worth exactly the same, only Company XYZ and Company (B) would (if we assume no unusual voting rights, etc) form a group. Thus, Company XYZ would then not be 'mainly' the holding company of a trading group; it would be 'mainly' a company holding investments (in Company (A) and Company (C)) and therefore, again (but for a slightly different reason), no relief would apply.

Restrictions on relief — 'excepted assets'

[3.37]

Even if the requirements for BPR are met, an asset within a business or company will be denied BPR as an 'excepted asset' under IHTA 1984, s 112(2) if it is neither:

- used wholly or mainly for the purposes of the business during the previous two years or, if it has not been owned for two years, its entire period of ownership; nor
- required at the time of the transfer for the future use of the business.

The asset most commonly identified as an 'excepted asset' by HMRC is surplus cash within a business, and here there are parallels to the ER issues discussed above. HMRC will accept that every business requires a level of cash for day to day purposes – but the amount required will vary from business to business. In relation to any cash amounts held in excess of these requirements, HMRC will want to know for what 'future use' the cash is required.

In *Barclays Bank Trust Co Ltd v IRC* [1998] STC (SCD) 125, the executors failed in their argument that surplus cash within the business – which had in fact been used some seven years after the date of death to acquire an unrelated business – was *at the date of death* required for the future use of that business. It was held that whether an asset was so 'required' did not include the mere possibility that money might be required should an opportunity arise to make use of the money in the future, and that 'required implies some imperative that the money will fall to be used upon a given project or for some palpable business'.

In practice, HMRC will invariably refer to this case as authority for the denial of BPR where a company holds more than ‘working cash’ and where there are no definite future plans for the use of the excess. A close reading of the case is extremely helpful if faced with such a claim from HMRC as the facts were unusual and there may be good reasons to distinguish other cases from it.

In practice, as in relation to ER, it is imperative that evidence is always kept (ie in the form of board minutes, etc) as to why a business is holding cash not required for day-to-day business purposes.

An asset used wholly or mainly for the benefit of the owner of a business or of a person connected with him is deemed to be an excepted asset (s 112(6)) – for example, a property owned by the business but ‘mainly’ occupied by the owner as his home.

As mentioned above, the investment part of a mainly trading business is not per se treated as an excepted asset. An excepted asset cannot, by definition, be an asset used for the purposes of the business: however, the ‘business’ of a partly trading and partly investment business nevertheless includes an investment element. Thus, as the investment part is an element of the business, it cannot be an excepted asset.

It also needs to be remembered, however, that simply because a mainly trading company holds investments, this does not *necessarily* guarantee that those investments will attract relief. It always needs to be established that those investments constitute part of the ‘business’ of the company — i.e. by reference to the normal definition of what constitutes a ‘business’, discussed at **11.4** below.

Restrictions on relief — investment subsidiaries

[3.38]

Where, within a group, there is a subsidiary company which is itself wholly or mainly carrying on an investment business, the *value* of that subsidiary is denied BPR (IHTA 1984, s 111). Thus, in Example 1 above, the value of Company (C) would not attract relief.

This rule is, however, subject to the caveat that if that investment subsidiary's main business is ‘wholly or mainly’ the holding of land for other group trading companies, its value will not be denied relief (IHTA 1984, s 111(b)).

Interestingly, this caveat appears – on a strict reading of the legislation – to apply only to subsidiary companies within a group and not to the holding company of a group. Thus, where a holding company owns a property which is let to one of its trading subsidiaries, that property could be considered as an investment of the holding company when identifying the holding company's main business. The counter argument would be that in these circumstances it would be wrong to think about the property as an ‘investment’ of the holding group – rather it is a property held to facilitate the trade in other parts of the group – and it is to be hoped, in any event, that HMRC would never seek to use such an anomaly to deny BPR to a bona fide trading group.

Planning point

If a trading group holds investments, if possible they should not be kept together in one subsidiary where the holding of those investments comprises that subsidiary's main activity. Instead, they should be distributed around the group and held in companies where the main activity is the undertaking of some non-investment activity.

Planning point

It is the *value* of an investment subsidiary that is denied relief, and therefore any inter-group loans encumbering the subsidiary will reduce the amount of any restriction of relief.

Restrictions on relief — sole traders

[3.39]

A similar but perhaps more fundamental issue arises in relation to sole traders in that it is only those assets 'used in the business' (IHTA 1984, s 110(b)) which can attract BPR.

An interesting example of how this issue applies in practice is the Special Commissioners case of *Ninth Marquis of Hertford (executors of Eighth Marquess of Hertford, dec'd) v* IRC (SpC 444) [2005] STC (SCD) 177. The Marquis' estate at Ragley Hall was run as a business, with 78% of the Hall itself open to the public and 22% reserved under a lease as private quarters. HMRC sought to argue that the living quarters constituted a separate asset which was not part of the business and which should therefore be denied relief. The taxpayer argued that the business asset was the entire Hall, which was not *mainly* put to personal use and that therefore BPR should be available in relation to it in full. After considerable head-scratching, the Special Commissioner sided with the taxpayer – principally on the basis that anyone coming to the estate would view the Hall as one asset – and relief was therefore available in full.

Similar conceptual issues concerning the identification of one or two businesses were discussed and found in favour of the taxpayer in the *Brander* case referred to above.

The order of events — using the limitations to advantage?

[3.40]

The inheritance tax legislation does not state explicitly whether, when considering the availability of BPR, one should first undertake the 'wholly and mainly' test and then apply the restrictions only if the company is identified as mainly trading or whether the restrictions should be applied first with the 'wholly or mainly' test then carried out only in relation to the unrestricted assets. The difference between these approaches can be marked.

Take, for example, a company which is 40% trading, 30% investment and 30% excepted assets. At first blush, one might conclude that, as 60% of the company comprised investment or excepted assets, the 'wholly or mainly' test would be failed and therefore no relief at all should be available in relation to the company shares.

In fact, the position is a lot better than this. The 'wholly or mainly' test is used to identify the main business of the company. As explained above, an excepted asset cannot, by definition, be being used for the purposes of the business (ie it could not be an excepted asset if it were) and therefore, *before* applying the 'wholly or mainly' test, the excepted assets should be ignored.

When the 'wholly or mainly' test is then applied to the business, it is 40/70ths trading and 30/70ths investment. The business of the company is therefore mainly trading, so relief should be available in full (remembering that the investment part of a mixed but mainly trading business is not excluded from relief). The 30% which comprises excepted assets is denied relief, but a denial of relief in relation to 30% of the value is far better than no relief at all.

It is less clear that the same methodology can be applied when considering an investment subsidiary to which IHTA 1984, s 111 applies. This is because the legislation talks in terms of ignoring the *value* of the subsidiary. In the authors' view, it is arguable that the existence of an investment subsidiary should nevertheless be ignored when considering whether a holding company is 'mainly' the holding company of an investment group.

In relation to a sole trade, similar issues arise in determining which assets are comprised in the business. For example, trading premises with a let flat above it might be considered to be one business, which may or may not be mainly investment. Alternatively, it might be considered as two separate businesses, one of which is wholly trading and one of which is wholly investment.

If the trading element predominates, the taxpayer would be better to argue the former, as the investment element would then attract relief too. If circumstances are the other way around, it would be better to treat it as two businesses, so that at least the value of the trading would attract relief. The *Marquis of Hertford* and *Brander* cases referred to above illustrate how difficult determining questions of this sort can be.

Planning point

Sometimes it is preferable from a BPR perspective to keep trading assets and investments together. Thus, in a business which is 60:40 trading and investment, the value of the investments will qualify for relief because they are part of a mainly trading business. Outside that business, of course, they would be fully chargeable to inheritance tax.

Alternatively, it is sometimes better to keep businesses apart. A company which is 40:60 trading and investment would get no relief as it is mainly investment, whereas in separate businesses at least the trading element would attract relief.

Often, in relation to mixed businesses like this – particularly where the investment element of the businesses grows relative to the trading elements – there comes a point where the business tips over the 50% barrier into being mainly investment.

In these circumstances, it may be sensible to suffer a tax charge on an extraction of some of the investments from the business, to restore the trading dominance. Alternatively, some form of reconstruction might be considered (see Chapter 11).

Minimum ownership period

[3.41]

To qualify for relief, the owner must either have owned the business property throughout the previous two-year period (s 106) or be deemed to have satisfied that condition because of one of the following rules.

- Business property which has replaced other qualifying property can qualify for relief (IHTA 1984, s 107). This is explored more fully in Chapter 12 in the context of the incorporation of a business.
- Those who inherit relevant business property from their spouse on death can add the deceased spouse's period of ownership to their own (IHTA 1984, s 108).
- Business property which was subject to an earlier transfer can qualify for relief if it, or the earlier transfer, is made on death (IHTA 1984, s 109). This is explored more fully in Chapter 15 in connection with inter-spouse transfers of business assets prior to a death.
- In relation to unquoted shares, if new shares are identifiable with other previously owned shares for capital gains tax purposes – for example, in relation to a reorganisation – the period of ownership of the previously owned shares is included in relation to the new ones (IHTA 1984, s 107(4)).

It is important to note that the two-year requirement concerns only the *ownership* of the assets. In the authors' view, there is no specific requirement that the assets have to have qualified for relief during the entire two-year ownership period. As long as they have been owned for two years (or treated as such) and qualify for relief at the relevant time (ie death or the date of the gift), relief should be available.

Binding contracts for sale/liquidations

[3.42]

If a binding contract to sell has been entered into in relation to business property, BPR will not be available pending sale. Thus, care needs to be taken if a lifetime gift of business assets is being contemplated around the time of a sale.

More importantly, however, if any shareholders or partnership agreement contains a clause *requiring* a deceased shareholder's shares or partner's partnership interest to be purchased by the surviving shareholders or partners, that will constitute a binding contract for sale as at the date of death, thus denying relief at precisely the moment it is required.

Planning point

The same problem does not arise if the surviving shareholders or partners have *options* to purchase or if the estate of the deceased has an *option* to sell.

Likewise, accruer provisions in partnership deeds will not constitute a binding sale contract.

Relief is also denied in relation to a company in the process of a winding-up or liquidation, with exceptions where this is carried out as part of a reconstruction or amalgamation (see further IHTA 1984, s 105(5)).

Liabilities incurred to acquire business property

[3.43]

Finance Act 2013 introduced significant changes to the rules governing the deductibility of liabilities for inheritance tax purposes – including new rules in relation to liabilities incurred to finance property qualifying for BPR.

For deaths and chargeable transfers occurring on or after 17 July 2013, liabilities incurred *after* 6 April 2013 to finance the acquisition, maintenance or enhancement of property qualifying for BPR will first be deductible against such property.

Such loans were previously first deductible against property against which they were secured and the change blocks the common inheritance tax planning techniques of incurring debts secured on chargeable property to acquire BPR property, and of securing business loans on non-business assets.

Key points

[3.44]

Availability of relief	*ER (capital gains tax)*	*BPR (inheritance tax)*
Company's activities	The company must carry on trading activities, and the activities when taken together must not include substantial non-trading activities (a non-statutory business clearance application by a company permitted to determine whether the company is a qualifying trading company)	The company must not be wholly or mainly involved in dealing in securities, stocks or shares, or land or buildings, or making or holding investments
Measurement	80% test	51% test
Excepted assets	None. If the company qualifies, the relief applies to all assets	Excepted assets such as cash and assets used personally by the shareholders/directors must be excluded
Minimum holding requirement — unquoted company	The shareholder must have at least 5% of the ordinary shares and the entitlement to 5% of the votes by virtue of the shareholding and be an officer or employee of the company	No minimum holding requirement for an unquoted company
Minimum holding requirement — quoted company	The shareholder must have at least 5% of the ordinary shares and the entitlement to 5% of the votes by virtue of the shareholding and be an officer or employee of the company	The transferor must have control
Available in companies not meeting the activities	No	No

Availability of relief test	*ER (capital gains tax)*	*BPR (inheritance tax)*
Available to unincorporated businesses	Yes, where these are trading businesses and are carried on as a sole trader or in partnership	Yes, where these are an interest in a business which is not dealing in securities, stocks or shares, or land or buildings, or making or holding investments
Rates available	Gains of up to £10m — is chargeable to CGT at 10%	100% on unincorporated businesses, unquoted shares and unquoted securities giving control
		50% on listed shares giving control, land and buildings or plant and machinery used by a company in which the transferor has control or a partnership in which he is a partner
Relief for assets used by unconnected businesses	No	No
Restrictions on trade	No	No, but not available for property dealing or share dealing
Look-back period during which the company must meet the activity test	One year leading up to the date of disposal	Minimum holding requirement of two years, but must meet the activities test at the date of the transfer

The Front Line is where you stand face to face with HMRC and agree tax. It's not a place to be alone. Not a place to go to unprepared.

As the UK's only provider of critical tax information, in-depth reference, ground-breaking training and learning resources and unique market insight, Tolley is there by your side with four product families designed for tax professionals working on The Front Line.

Tolley® Insight | **Tolley® Guidance** | **Tolley® Library** | **Tolley® Learning**

Tolley, Lexis House, 30 Farringdon Street, London, EC4A 4HH

Tolley®

Tax intelligence from LexisNexis®