

Inheritance Tax relief for let cottages on an agricultural estate

July 2009

For Business Property Relief (“BPR”) to be available there has to be a business predominantly engaged in trading. This could consist of buying and/or selling goods or the provision of services or a mixture of both. However BPR will not be available to a business which consists wholly or mainly of holding or making investments. The predominant activity is unlikely to qualify as a trading activity if it is passive in nature. This might be the case where any returns are attributable only to the soundness of an investment and the state of the market, such as simply letting a cottage on an assured shorthold tenancy. The rule is harsh because, where it applies, no BPR will be available on the entire business.

The recent case of *Earl of Balfour v HM Revenue & Customs* is of particular interest because it gives some indication of the way a traditional landed estate will be treated. It suggests (following cases such as *Farmer v IRC*) that BPR may be available if let properties are shown to be part only of a single composite business and such lettings are not the main activity carried on by that business.

Facts

Prior to November 2002 Lord Balfour was liferenter (Scottish equivalent to a life interest) of the Whittingehame Estate in East Lothian. The Estate included 771.85 hectares of lowland agricultural land, an historic tower house, 2 farms in-hand, 3 farms let on secure agricultural tenancies, 393.6 hectares of woodland and 26 cottages mostly let on assured shorthold tenancies. From November 2002 Lord Balfour was the freehold owner of the Estate and remained so until his death in June 2003. The income from the in-hand farming operations exceeded the income generated by the letting of the property.

Throughout the period with which the appeal was concerned, Lord Balfour carried on the business of the Estate either as a sole trader or in a partnership of which the property formed part of the partnership capital. Prior to November 2002 the Estate trustees were not actively involved in Estate administration, and generally acted under Lord Balfour’s instructions. Lord Balfour meanwhile supervised staff matters, the letting activities, forestry work, property disposals and overall estate administration with the assistance of his secretary. As Lord Balfour’s health declined, the land agent, Bidwells, took an increasing role in day-to-day administration, but continued reporting directly to Lord Balfour on all matters.

The Tribunal’s findings

The Tribunal held that, despite the 26 let cottages, the business did not consist mainly of making or holding investments and therefore BPR was available. The Tribunal felt that to conclude otherwise would belittle the efforts made by Lord Balfour to manage the various components of the Estate properly and profitably. The Tribunal commented that even the residential lettings required Lord Balfour’s “*experience, business acumen and careful planning*”. The cottages were historically part of the Estate’s farming operations and Lord Balfour had taken care to obtain a benefit for the whole estate when letting property; e.g. by letting to Estate employees or to individuals with skills that might benefit the Estate.

The Tribunal considered it entirely unnecessary to do any kind of quantitative analysis of the various activities. Instead, one need only assess what the preponderance of business activity is by looking at a variety of factors; turnover, profit, expenditure and time spent. A quantitative analysis is impossible without records of every hour spent by every employee, every item of income and expenditure and details of overlapping activities. It is more a matter of general assessment and impression, by looking at the activities of the estate in the round. On this basis, the Tribunal concluded the lettings (the passive activities) were very much ancillary to the farming, forestry and shooting activities (the trading activities).

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Practical Implications

For farmers and landowners with a diversified estate consisting of let cottages, farmland and woodland, this case again demonstrates the importance of treating both the investment (passive) and non-investment (trading) activities as one composite business where the letting activities are ancillary to the farming, forestry and woodland activities. In particular:-

1. ensure both the farming activities and lettings are run by the same person (whether that is the owner, an employee or an agent). When employing staff or agents, ensure they do not deal exclusively with the lettings and investments in isolation from the farming activities. In other words the activities are interlaced and dovetailed in with each other;
2. keep accurate records of meetings with professional advisors, trustees and employees and, importantly, details of why certain management decisions have been made;
3. put in place composite accounts encompassing all aspects of the estate's business, rather than separate farming and estate accounts;
4. make lettings and other investments beneficial to the estate as a whole. Lord Balfour, for example, selected tenants with skills that would directly or indirectly benefit his Estate, even if such tenants were not to be full time employees. Keep records of why each tenant has been selected;
5. put in place a business plan encompassing the whole estate and not just separate parts of it. There needs to be an intention to make a profit;
6. avoid creating management structures that could be perceived as segregating the composite enterprise; and,
7. ensure that any grazing agreements are arranged in such a way that the landowner will be regarded as a farmer who is growing the grass as a crop.

Conclusion

The Tribunal in *Balfour* was mindful of Lord Balfour's efforts to run the Estate for his own benefit and to preserve it for his heirs. While it is comforting to landowners for there to have been judicial recognition of the difficulties facing farms and estates, it should be noted that HM Revenue & Customs are examining claims for BPR with increasing scrutiny. It is therefore vital to ensure that you have the evidence to put the best case forward as possible when considering claiming BPR. It has not been confirmed whether the Revenue will appeal against the Tribunal's decision.

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