Business Property Relief

Business Property Relief (BPR) is one of the most valuable tax reliefs available to business owners. This month’s CPD paper will offer an introduction to BPR and the requirements a business must meet to qualify for the relief.

**WHAT IS BPR?**

BPR is a relief applied to Inheritance Tax (IHT) on qualifying business assets. BPR may be applied at either 100% or 50%, depending on the type of business, how the business is owned and the structure of the business (s104 Inheritance Tax Act 1984).

BPR is available on transfers on death and on certain lifetime transfers, such as transfers into *inter vivos* trusts.

BPR concerns business assets. For agricultural assets there is a different set of rules and a different relief available known as Agricultural Property Relief (APR). Assets that qualify for APR will not qualify for BPR, though there is some overlap; transfer of agricultural assets to attract BPR if they fail to qualify for APR.

**WHAT IS A BUSINESS?**

The legal definition of a business was set out in the case of *CEC v Lord Fisher* [1981] STC 238; although this case concerned the definition of a business for VAT purposes. There are six key questions that need to be considered when establishing whether an activity is a business:

1. Is the activity a ‘serious undertaking earnestly pursued’?
2. Is the activity an occupation or function actively pursued with reasonable recognisable continuity?
3. Does the activity have a certain measure of substance as measured by quarterly or annual value of taxable supplies made?
4. Is the activity conducted in a regular manner and on sound and recognised business principles?
5. Is the activity predominately concerned with the making of taxable supplies to consumers for consideration?
6. Are the taxable supplies that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them?

**QUALIFYING FOR BPR**

Not all businesses will qualify for BPR, so never assume that a client’s business will automatically attract relief. There are a number of conditions to be met, broadly:

1. The business must be a qualifying business
2. The business property must be ‘relevant business property’
3. The minimum ownership period condition must be met
**Qualifying Business**

Broadly, to be considered a qualifying business it must be a trading business. This includes ‘a business carried on in the exercise of a profession or vocation, but does not include a business carried on otherwise than for gain.’ (s103(3) IHTA 1984). Therefore most businesses carried on for profit are likely to be qualifying.

There are certain activities that are not qualifying businesses even if carried on for gain. These are businesses that consist wholly or mainly of dealing in securities, stocks and shares, land or buildings or making or holding investments (s105(3) IHTA 1984). Therefore a buy-to-let business will not qualify as this will be classed as an investment.

Your priority is to determine what your client’s main business activity is and establish if it falls under the rules to obtain business relief. Where a client has a business that carries out mixed activities it may attract BPR even if part of it consists of non-qualifying activities. In these cases the ‘wholly or mainly’ test should be applied. Under this test a business may attract BPR if their business only partly deals in the activities listed in s105(3).

The ‘wholly or mainly’ test has been frequently argued by commercial landlords who have attempted to say that they are entitled to relief because they actively manage their land, rather than act as passive landlords. Many have been unsuccessful in proving such a claim through the courts. This can be seen in the cases of *Martin and another (executors of Moore deceased) v CIR* [1995] STC (SCD). This has even gone as far as preventing BPR on a business offering furnished holiday lets as the services provided were ‘unlikely to be material’ (*HMRC v Mrs N V Pawson’s Personal Representative* [2013] UKUT 050).

Case law suggests that for a business to pass the ‘wholly or mainly’ test more than 50% of the business must not consist of the activities in s105(3), although each case turns on its own facts and the test has been applied flexibly. The most influential example being the case of *Farmer (executors of Farmer) v IRC* [1999] STC (SCD). In this case the deceased was a farmer whose estate consisted of various farms, some of which were let out, some farmed on a contractual basis, and 26 residential properties that were let out. The two farms that were trading made up only 35% of the estate, whereas the let farms and properties made up the rest. Nevertheless, after considering various factors such as turnover, net profit, and time spend in farming activities, it was decided that the business consisted mainly of farming and so BPR was allowed.

**‘Relevant Business Property’**

A business must contain ‘relevant business property’ to qualify for relief. What constitutes relevant business property is defined by s105(1) IHTA 1984. Relief can be claimed on the following:

1. A business or an interest in a business
2. A holding of shares in an unquoted company
3. Control holding of shares in a quoted company
4. Land or buildings, machinery or plant used wholly or mainly for the purposes of the business carried on by a company or partnership
5. Land or buildings, machinery or plant held in a trust in which the transferor had an interest in possession and which was used in his business

There are some assets on which BPR is not available, known as ‘excepted assets’. An asset is treated as an excepted asset if it was not used wholly or mainly for business purposes in the two years prior to the transfer, unless it was required for future use in the business (s112(2) IHTA 1984). This prevents otherwise taxable assets avoiding IHT by being sheltered within a business that qualifies for BPR, for example by a director transferring privately used assets to the company.

Assets surplus to requirements, including excess cash reserves, may also be considered excepted assets. This can create a problem for a business owner who has retained cash reserves to cover a potential downturn in trade, for example if their business is seasonal. Unfortunately unless it can be shown that this was being held for some identifiable future purpose it will be considered an excepted asset and no BPR will be available. This will not prevent other assets attracting relief though.

Ownership Period

The relevant business property must have been owned for a minimum period of 2 years immediately before the transfer (s106 IHTA 1984). The qualifying ownership period can be accumulated between spouses. The business does not have to have been owned for a minimum of 2 years before being passed to the spouse as it will pass to them free of IHT anyway. However, for the surviving spouse to be able to pass on the business assets free of IHT they must have owned the business for a period of 2 years combined with the deceased spouses ownership period. For example if a business owner dies having held the business for only 1 year it may still attract relief if it was previously held by a spouse for at least 1 year beforehand (108(b) IHTA 1984).

Regarding replacement property, where the original relevant business property was disposed of before the transferor’s death and the proceeds were used to purchase replacement property BPR may still be available as long as the requirements of s107 IHTA 1984 are met:

(1)Property shall be treated as satisfying the condition in section 106 above if—

(a) it replaced other property and it, that other property and any property directly or indirectly replaced by that other property were owned by the transferor for periods which together comprised at least two years falling within the five years immediately preceding the transfer of value, and

(b) any other property concerned was such that, had the transfer of value been made immediately before it was replaced, it would (apart from section 106) have been relevant business property in relation to the transfer.

The replacement property, although not owned for the two year time period, will qualify for business relief but until it has been owned for the two year time period, the value of the replacement property is limited to the value of the original property it replaced.
### Rates of Relief

BPR is available at either 100% or 50%. The following table shows which types of business will qualify for what rate of BPR:

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Rate of BPR</th>
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</thead>
<tbody>
<tr>
<td>A business or interest in a business</td>
<td>100%</td>
</tr>
<tr>
<td>Shares in an unquoted company</td>
<td>100%</td>
</tr>
<tr>
<td>Control holding of shares in a quoted company</td>
<td>50%</td>
</tr>
<tr>
<td>Land, buildings or machinery owned by the transferor and used in a business they were a partner in or controlled</td>
<td>50%</td>
</tr>
<tr>
<td>Land or buildings, machinery or plant held in a trust in which the transferor had an interest in possession and which was used in his business</td>
<td>50%</td>
</tr>
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### How can BPR be lost?

BPR can be easily lost. Property that would otherwise qualify for BPR will fail to attract relief if at the time of the transfer it is subject to a binding contract for sale. s113 IHTA 1984:

Where any property would be relevant business property in relation to a transfer of value but a binding contract for its sale has been entered into at the time of the transfer, it is not relevant business property in relation to the transfer unless—

(a) the property is a business or interest in a business and the sale is to a company which is to carry on the business and is made in consideration wholly or mainly of shares in or securities of that company, or

(b) the property is shares in or securities of a company and the sale is made for the purpose of reconstruction or amalgamation.

This can be an easy trap to fall into as it’s not uncommon for a shareholders or partnership agreement to contain provisions stating that a deceased partner’s interest must be sold to the surviving partners, creating a binding contract for sale. This can be avoided by using cross-option agreements in combination with life insurance policies for each partner, which would provide the funds necessary to purchase the deceased’s interest. Under a cross-option agreement the deceased’s executors have the option to sell the shares to the surviving partners (a put option), or the surviving partners have the option to purchase the shares from the executors (a call option). The way this is arranged prevents a binding contract for sale.

BPR can also be lost if certain assets are owned outside of the business. For example in the case of a family business where the children own shares in the company, but the business premises itself is owned by the parents as individuals and let to the business. Where property is owned outside of the
company BPR will only be available at a rate of 50%, and then only if the owner of the property used by the business had a controlling interest in the company. If the parents were not shareholders in the company, or did not have a controlling interest, then no BPR would be available.

**CONCLUSION**

What we have seen is that certain business interests will qualify for BPR, providing the assets are considered to be relevant property and are used wholly or mainly in the undertaking of a business activity. Whether the business will qualify for relief at 100% or 50% will depend on the type of business property. Priority must be given to ensure these assets will receive any relief the business activity qualifies. Also give consideration to the length of time that the transferor has owned the property ensuring it is for the required period, being a clear two years of ownership.

These notes are produced solely for the benefit of SWW members when completing the November 2017 CPD test to gain 1 hour of CPD towards their annual quota. The notes do not represent legal advice and no reliance can be made on the content of the notes in any particular or individual specific client circumstances. Having read the notes members should cement their understanding by considering further reading around the subject.