

The Balfour Case -an Inheritance Tax Opportunity for Landed Estates?

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INTRODUCTION

The Upper Tax Tribunal's decision to dismiss HMRC's appeal in the Balfour case has recently been published. This decision is an important one for landowners and their advisers as it potentially changes the approach to inheritance tax planning in relation to the ownership and management of landed estates.

BACKGROUND

The Balfour case related to the availability of Business Property Relief (BPR) to the Whittingehame estate of the late Lord Balfour. Lord Balfour died on 27 June 2003 and held his interest in the estate in a partnership with his nephew. In the absence of BPR, his Executors would have been liable to inheritance tax on the value of the non-agricultural estate assets at a rate of 40%.

BPR is available at a rate of 100% of the value of any assets which qualify as relevant business property. This includes any property "consisting of a business or an interest in a business". Accordingly, for assets to qualify, a business activity must be carried out and, importantly, this cannot consist "wholly or mainly of making or holding investments".

In the case of Balfour, the estate covered 1,907 acres and comprised a mixture of trading and investment activities - 2 in-hand farms, 3 let farms, 26 let cottages, 2 let commercial units and various woodlands, parks and sporting rights. The Executors claimed that the estate was managed as one composite business with Lord Balfour presiding over all business decisions. On Lord Balfour's death, the Executors therefore claimed BPR in full against his partnership interest.

However, HMRC rejected this claim on a number of grounds. In particular they contended that as the estate included a large number of rental properties, the partnership was not undertaking a business activity and was instead "making or holding investments". In addition, HMRC contested that the minimum qualifying period of ownership of two years had not been met as the estate had been owned by various entities – family trusts, a company, a partnership and Lord Balfour himself – in the two year period leading up to Lord Balfour's death.

THE APPEAL

The Executors disputed HMRC's determination and applied to the Tax Tribunal. The judge sided with the Executors and

concluded in May 2009 that BPR should have been available in full against the value of the estate. HMRC recently appealed - unsuccessfully - to the Upper Tax Tribunal.

The key to the Tribunal's decision was whether or not BPR should apply to a business where there is a mixture of trading and investment activities.

In this case Lord Balfour's "business" was running the estate, which included managing let properties. A number of factors were considered in deliberating this point, including a review of turnover and net profit, the time spent by Lord Balfour and his consultants on each activity, the capital allocation between activities and how the accounts were drawn up.

The overriding factor was whether the estate was, in the overall context, run as one composite business or as a collection of trading activities and investments. Ultimately, it was deemed that Lord Balfour's involvement across the estate, regardless of the ownership of the assets at various stages, demonstrated the former to be the case, and that the letting activities on the estate were ancillary to the main business of the estate, which was farming.

Whilst it is unclear what HMRC's next move will be – they can appeal to a higher court – this decision is of particular interest to landowners and their advisers.

WHAT CAN WE TAKE FROM THIS CASE?

The main positive implication from the case is that it appears that the existence of investment activities within a business – which were not insignificant in the Balfour case - do not necessarily preclude the availability of BPR on a mixed use estate.

It is clear that any view needs to be taken in the overall context of the estate and will be on a case-by-case basis. It is therefore unlikely that any short term measures, such as a simple change to the way in which accounts are drawn up, are likely to impact significantly on the availability of BPR.

Furthermore, HMRC will be scrutinising similar estates in future as a result of this decision and are likely to take a dim view of any short term action taken in an attempt to align the estate's profile with that of Balfour. However, where an estate is already being run as if it were a single composite business

consideration should be given as to what steps can be taken to strengthen an argument for BPR.

The profile of the client is also relevant. The availability of BPR is less likely to be of particular relevance to a landowner who is relatively young and in good health. However, changes could be implemented now with a view to the longer term to strengthen an argument that the estate is being run as one business. These might include:

- Maintaining a homogeneous management structure with one single business plan, management accounts and meetings, bank account and payroll to cover the entire estate.
- Maintaining a simple operating and ownership structure. In practice, it may not be possible to restructure ownerships without crystallising capital gains tax liabilities.
- De-segregation of work across the estate. Ensure that, insofar as it is possible, all employees, professional advisers and the landowner themselves spread their time between both the trading and investment activities. Increasing the level of trading activities against investment activities. An example for this would be bringing a let cottage into the trade by letting it to a farm worker on an agricultural tenancy.
- Segregation of investment activities where it is clear that their inclusion would cause the trading activities to be outweighed.
- Maintenance of robust accounting and other records to support a claim for BPR in the event of an enquiry from HMRC.

The ramifications of HMRC's unsuccessful appeal could, in the right circumstances, be of significant value to a number of landowners. Clearly, professional advice should be sought prior to making any decision.

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