Specialist sectors

Management of liabilities and cash deposits

Long term debt is an ever present fact of most farmers' lives.

The rescheduling of debt can be used to advantage in inheritance tax planning. It is of particular use to farmers due to the wording of agricultural property relief (APR) provisions compared with those of business property relief (BPR). There is not the scope in this article to go into the full detail but to highlight this under-utilised useful tax planning tool. The basic BPR and APR rules must be understood. Rescheduling liabilities is not a potentially exempt transfer (it is not a transfer at all) and therefore there is no seven year wait before full benefit is achieved.

For BPR where a liability is charged on an asset used in the business the value of the asset is reduced by the amount of the debt, even if the debt was *not* incurred for the business. Under *IHTA 1984 s162(4)* for APR and BPR a 'liability which is an encumbrance on any property shall, so far as possible, be taken to reduce the value of that property' and under *s110* 'the value of a business or of an interest in a business shall be taken to be its net value'. Inheritance tax relief will therefore only be available on the net amount. Liquid funds outside the business would be liable to IHT at the maximum rate, but they give scope to repay debts, on assets which qualify for BPR – e.g. a farmer with a mortgage charged on the land of £100,000 and an overdraft of £50,000 should reduce the borrowings on the land first from, say, a cash legacy, so enabling the full value to qualify for APR. The philosophy of the taxpayers towards borrowings and cash reserves varies considerably and some might not like debt management to be tax driven. However, this is one of the few tax planning points that can be 'death bed' tax planning.

Cash deposits in the business do not qualify for BPR

Questions commonly asked by the Capital Taxes Office are:

- Are the assets used at all in the business?
- Were they used throughout the whole of the two years prior to the claim?
- Was the asset required, at the time of transfer, for future use in the business?

The proactive tax planner would try and take this planning further by actively leaving money or minor investments in the business and arguing that they are needed in the business. Short-term deposits are more likely to qualify for BPR than long-term fixed deposits. There must be justification of palpable qualifying business purpose. In particular the relief must not be put at risk by the exclusion in *IHTA 1984 s105* for companies which wholly or mainly hold investments. The case of *Brown v CIR* showed that tax relief for the 'money box' can be achieved but the claim must be supported by records.

The allocation of liabilities and debt are an excellent tax planning tool. A review of debts and liabilities should be undertaken.

Agricultural value

When considering tax planning it is often overlooked that APR is restricted to the agricultural value. So how is the agricultural value defined? It is limited by *IHTA 1984 s115(3)* to 'The value which would be the value of the property if the property was subject to a perpetual covenant prohibiting its use otherwise than as agricultural property'. Priority is given to APR under *s116(1)* over BPR: i.e. when property qualifies for both reliefs APR is given rather than BPR.

The first point that any tax planner would worry about (as indeed would their clients) is the fact that the market value of agricultural property might well exceed its agricultural value and therefore could be an excess of market value over agricultural value which would be chargeable to inheritance tax. It is at this point that we look at the scope to claim BPR on the excess.

Excess value could be created by sporting rights which would have a considerable influence on the value of agricultural land. As the raising of pheasants is not deemed to be (in most instances) for the purpose of the production of food then this would not qualify as agricultural and a business property relief claim would need to be considered. In these instances, as with any form of diversification, it will be important to examine just exactly how the shoot is run and how it is managed as a business. Thus, the landowner might not secure APR on the value of the sporting rights but it could well be that BPR would be claimed on the business element of the shoot, i.e. the exploitation of those rights. It is important that there is evidence that the business has been run on a commercial basis.

Review the tax computation

With the complexity of farming, e.g. herds basis, averaging, APR, exempt woodland income, it is essential to ensure that the tax computation of the diversifying business is regularly reviewed and allocated correctly between farming and not farming.

Farmer & Giles (Farmer's executors) v IRC SpC216

Key tax planning issues arose from this case for a landed estate claiming BPR against let property. The need to have let property mixed with farming operations is relevant. A review of the case is a must. The attacks by the Revenue in the recent cases of *Antrobus* and *Higgison* should not be overlooked.

Incorporation

Can advantage be taken of the current advantageous corporation tax rates? Although companies have potential problems for farming, e.g. no business asset tax relief in the company, losses trapped in the company etc, it could be used to protect a risk area of diversification. Also, although farming is excluded from EIS the diversified business might qualify and could be a good way of raising capital.

As a practical planning point it is important to see that every asset owned by landowning clients is reviewed regularly and consideration given as to whether APR can still be claimed. If APR is going to be lost due to diversification careful consideration must be given to ensure that BPR can be claimed. When looking at this it is important in the first instance to ensure that there is a business. It is important to look at VAT and case law when considering the element subject to BPR. Whilst carrying out this exercise it is a practical tax planning point to health check all areas such as Wills, possible gifting now and checking for the existence of gratuitous licences etc.

JULIE M BUTLER