Inheritance Tax

48. Deeds of variation

As reported in TAXline in January 2002 (see Practical Point No 15), the Capital Taxes Office (CTO) published a newsletter last month which contains some interesting comments concerning deeds of variation under section 142, IHTA 1984.

The CTO say that deeds of variation must be capable of being implemented in the real world and that the instrument in writing must be more than an empty piece of paper. The CTO gives as an example the situation where A leaves a life interest in property to B with remainder to C. On B's death (but within two years of A's death) C might make a deed of variation to vary A's will be redirecting B's interest to C. It says that in the real world, B's interest does not exist at that time and there is nothing for the deed to do, so Section 142 simply cannot apply.

This is an interesting interpretation, but personally I do not think that it makes sense. The whole of section 142 is in any event artificial; it is to rewrite the will retrospectively of a deceased person and to treat the retrospectively revised will as if the deceased had made completely different dispositions on his death from those which had actually been made.

The position is not helped by the fact that the variation in the CTO example would not be made by C, at least not on his own. It would be made by B's executors and C being the persons whose interests would be affected.

There is no dispute that a deed of variation can be made by the executors of a deceased beneficiary and that makes the entire thing even more artificial. But that is the purpose of section 142. In the Inland Revenue's example, at the time of the variation, C was entitled to the relevant assets and after the deed of variation he is still entitled to the relevant assets. The difference is the route by which he obtained them. By the deed of variation the assets pass directly from A to C rather than via B. This is not an empty piece of paper because this could increase or decrease the amount of inheritance tax payable on A's death or on B's death.

The suggestion seems to be that the deed of variation is ineffective under the general law. One is forced to enquire what the general law has to do with it; this is a deeming provision relating solely to fictions upon which a charge to tax is based. It may have an effect in the real world but maybe not. To say that in the real world B's interest does not exist and there is nothing for the deed to do seems entirely irrelevant. What if the asset had been a short lease which had expired before B's death or indeed with two years during B's lifetime? Is B (or are B's executors) precluded from executing a deed of variation in respect of the lease?

I suspect that we have not heard the last of this issue.

Contributed by Peter Vaines, Haarmann Hemmelrath

Farming

49. The need for diversification

With the farming industry moving towards greater diversification there is a need to consider carefully how business tax computations are prepared and to plan for future reliefs.

Farming has always been a unique industry. There are tax reliefs that relate exclusively to the business of agriculture. Clear examples of this are farmers' averaging, the 'five year rule' for losses (as extended 'temporarily' in December 2000), agricultural property relief (APR) for inheritance tax, reliefs available for farmhouses and the fact that farming is treated as 'one trade'.

As the returns from agriculture may no longer be sufficient to generate sufficient income for the farmer to live on, many farmers are having to look at alternative types of farming or alternative use of land and building to generate an income. It is very important when looking at diversification to ensure that income is clearly split between farming activities and non-farming activities. The definition of farming is set out in section 832(1), ICTA 1988 as 'the occupation of land wholly or mainly for the purposes of husbandry'. So what activities are considered farming? These can include 'set aside', income from grazing, short rotation coppice together with farm shops selling farm produce. However, items which are not considered farming include land let for 365 days or more, crops that grow naturally, grazing for horses, income from industrial units, quota leasing and share farming agreement with minimum return.

When practitioners prepare the farm tax computation, it is important to remove the above non-farming income items and also to match the expenses. In practice, many practitioners are just preparing a computation which arrives at a Schedule D Case I net profit or loss, with little regard for the allocation of expenses and income. It could be that income from items such as quota leasing and grazing by horses are inflating the profit for the purposes of the five year rule.

As a practical planning point, it is important to review all clients who are associated with farming to ensure the correct treatment of income and expenses. It will also be essential to review what future reliefs the client may need to claim, e.g. considering the 'commerciality' of the farm or the business. It is also useful to ask such questions as does the client intend to claim APR for inheritance tax purposes? If APR is lost will business property relief still be available? Could the eligibility for retirement relief be utilised before it disappears?

While reviewing the tax computation it is essential to see that our clients are still eligible for tax reliefs that are dependent on 'business/commercial' status. Examples of reliefs which could be lost are business taper relief and rollover relief for capital gains tax.

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