



DEFINING INVESTMENTS

As HMRC reclassifies trading businesses as investment businesses, claims for BPR will be at risk, warns **Julie Butler**

HMRC is trying to reclassify a trading business as an investment business in order to collect more inheritance tax (IHT) as shown in recent tax tribunal cases, for example, *Pawson* [2013] UKUT 050 (TCC), *McCall* [2009] NICA 12 and *Zetland* TC 02690, where in each case the taxpayer lost.

If HMRC can prove that a business is an investment business as opposed to a trading business, then it can deny the eligibility to business property relief (BPR) and collect more IHT. It is now official that HMRC is looking closely at all claims for BPR and agricultural property relief (APR). The HMRC approach appears to have been to consider a business in the context of the 'investment line' with regard to land-based businesses as opposed to looking at a business in the context of the 'badges of trade' and 'the thoughts of an intelligent businessman'.

HMRC, where appropriate, tries to contest claims for BPR on the grounds that activities do not amount to a trading business, and/or even if such activities amount to a business, that the business consists wholly or mainly of making or holding investments.

The meaning of 'business' is not defined for IHT purposes, so a business has its ordinary meaning, which is a trade or profession carried on for gain. The Inheritance Tax Act [IHTA 1984/ s103(3)] says that businesses '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'. The effect of this is to exclude lossmaking or 'hobby' businesses.

DEFINING A BUSINESS

Guidance was given in *Pawson v HMRC* (2012) UK FTT 51 and *HMRC v Pawson* (2013) UKUT 50. The First Tier Tribunal (FTT) held that the **▶ 32**

deceased's letting of holiday accommodation was a business, applying business tests laid down in *McCall* (2009) STC 990. However, this was overturned by the Upper Tribunal (UT) where it was held that the additional services associated with the holiday accommodation did not change the nature of the business from investment to trading.

In the reversed decision, Lord Justice Briggs set out his view of the 'investment line' which is understood to be:

- in relation to property based businesses, there was a 'spectrum' at one end of businesses (such as hotels) where large numbers of services were provided in addition to the simple use of the property and which qualified for BPR, and those at the other end where no additional services were provided, which did not (such as ordinary property lets); and
- that there was no presumption that a property business was an 'investment' business for BPR purposes and that in each case a decision had to be made as to where on the spectrum the business lay.

RATE OF RELIEF

In considering the eligibility for a BPR claim, it is key to note that BPR is a percentage of relevant business property (RBP).

For unincorporated businesses (sole traders and partnerships, as is the case with most farming businesses), the most important categories of RBP are:

- a business or an interest in a business (eg, a share in a partnership) (s105(1)(a) IHTA 1984) rate of relief for BPR 100%; and
- land or buildings, or machinery or plant used wholly or mainly for the purposes of a company controlled by the transferor or a partnership of which he was a partner (s105(1)(d) IHTA 1984) rate of relief for BPR 50%

A business which consists wholly or mainly of making or holding investments is not RBP (s105(3) IHTA 1984). In recent years, HMRC has been trying to argue that many land-based businesses fall over the 'investment line' and do not qualify as RBP. As was noted in *Pawson*, there must be no presumption that a business which



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involves property is an investment business. HMRC will try and attack property used in a partnership that is not partnership property and therefore it will restrict BPR to 50%.

However, denying BPR because the operation has 'crossed the investment line' is a 100% IHT relief prize for HMRC, not just 50%. As a result, all the BPR on the genuine trading element could be lost with the attack on the overall business status.

AVOIDING BALFOUR

Imagine the tax calamity if *Balfour (Brander (representative of Fourth Earl of Balfour) v HMRC [2010] STC 2666)* had failed in the claim for BPR. As a result of concerns of a 'Balfour failure', tests are carried out to check the business element and this is why many businesses that involve property ownership conduct the exercise known as 'the Balfour matrix'. This exercise looks at the business structure, income, profits, hours spent and capital values over a period. The aim is to identify a 'Balfour failure', ie, to confirm it has not passed the investment line while the taxpayer is still alive as a protection.

HMRC is attacking a number of areas over the eligibility of BPR. These include the farming operation and the landed estate where the investment activity has overtaken the trading activity, as seen in *Farmer (Farmer's Executors) v IRC [1999] STC SCD 321* and *Balfour* respectively.

Another area under the spotlight is the office accommodation operation with a mix of trading and investment activities with some degree of services. One such example of an IHT tribunal case is *Trustees of David Zetland Settlement v HMRC [2013] UKFTT 284 (TC)*. However, some joy was achieved from the capital gains tax (CGT) case of *Ramsay (Elisabeth Moyne Ramsay) v HMRC [2013] UK UT 226 (TCC)*.

While *Ramsay* is a CGT case, it was a success for the taxpayer arguing that the amount of services provided did create a trading business and the facts contained therein are useful for



those advisers wanting to achieve BPR for their clients as part of the accumulation of evidence to support the BPR claim.

It is suggested that the arguments to present to HMRC are the indications of business, the badges of trade, together with all the facts that are known to support the argument that there is a disciplined business seriously undertaken. There are elements of the farming operation which HMRC tries to argue is an investment business not a trading business. For example, grazing agreements have been looked at in length through *McCall v HMRC* [2009] and the case clearly sets out the services that should have been provided.

HORSE LIVERIES

Another area HMRC is targeting is the trade of horse liveries where licences are given to customers with horses on their land. For anybody involved in this area of equine trade, it is well known that such an activity is hard work and an 'intelligent businessman' would see this as a trading operation.

Various matters must be looked at in order to evidence the claim for BPR, ie, it is essential that trading accounts are prepared. It is important to ensure that HMRC accepted the operation as trading on the income tax return and Class 4 National Insurance was paid on trading profits.

Part of the fact finding is to understand what is really happening on the ground. Have the full facts been considered? Is it an activity conducted in a regular manner on a sound and recognised business principle? Is the business principally concerned with strong turnover? For example, are there a large number of liveries that change all the time? Is there evidence that the proprietor has carried out positive marketing for new liveries?



Businesses should ensure that evidence of trading, in order to achieve BPR, is on file

As mentioned, one point that has come through from the tribunal case of *Pawson* is that HMRC must not have a starting point of the assumption that a land-based business is an investment business. Using the example of DIY liveries, there might be an activity that is a serious undertaking and earnestly pursued, and that there is reasonable and recognisable continuity. In the view of an 'intelligent businessman', a DIY operation that does provide services is a trading business, but HMRC could try and employ the investment line approach.

ACTION PLAN

There is no doubt that the owner of a property-based business will need a portfolio of evidence to show what side of the investment line the business falls on and how to beat HMRC in its aggressive and fairly unpleasant attack on genuine businesses trading and operating well into the old age (of the proprietor and taxpayer).

Clearly, it is essential that the portfolio of evidence to show a trading operation is obtained now. To repeat the well-known phrase, after death 'your best witness will be dead'. Therefore, the evidence must be obtained while the taxpayer can provide evidence to show how hard they work, how many hours a week and what it takes to control the areas of the business. Recording time spent is an essential criterion.

All businesses should ensure that such evidence of trading, in order to achieve BPR, is on file now. There is some detailed information for advisers to obtain. Hopefully, there will be bulging permanent files supporting future IHT claims. If such evidence is not available, HMRC could try to deny tax relief where genuine relief is due.



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