

# Good housekeeping



Gathering careful evidence and ensuring everything is in order about gifts and loans is essential to realise tax planning potential for farmers, says *Julie Butler*

**M**any farming families are confused about land ownership and how it's shared. There can also be misinterpretation and uncertainty over gifts and loans between family members and trading operations. The need to evidence and clarify gifts and loans has been highlighted in the recent case of Mrs G Silber (personal representative of the estate of Mr M Lerner deceased) (TC2369).

Mr M Lerner died in 1999 at which time he owned the entire share capital in Towvale Ltd, an unquoted company. Before death, he made a loan of £107,210

to the company. The appellant (the personal representative of the deceased's estate) reported that the £107,210 should not form part of the estate because it had been a gift, rather than a loan. Therefore it did not form part of the estate and was not liable to inheritance tax (IHT).

But HMRC argued that the gift was a loan. There was no evidence that the transaction had been a gift. For example, it was shown in the company accounts as an amount due to a creditor, that is the deceased, so the loan was liable to IHT. The taxpayer's appeal was dismissed.

## Direct evidence

There can be distinct IHT advantages of a gift opposed to a loan, provided the donor survives seven years (or a "sliding scale" of that) and "manipulation" by taxpayers could come in to consideration to maximise tax efficiency. Direct evidence in such cases is essential; indirect evidence though, for example how the monies are shown in the farm accounts, is helpful.

In recent years, HMRC has been paying particularly close attention to lifetime transfers. Not only has it looked at estates, it has been reviewing other aspects

of estates that it knows may give rise to a lifetime transfer.

Such areas of review are as follows:

- **Joint assets:** gifts can arise on a transfer into joint names or where a joint owner receives the benefit of withdrawals from accounts funded wholly by the deceased.
  - **Loans:** gifts can arise on the forgiveness of a debt or part of a debt.
  - **Movement of funds** between multiple bank accounts: this can lead to gifts being overlooked (see below).
  - **Inheritance:** gifts can arise if there have been redistributions of property inherited by the deceased.
  - **Business or partnership:** transfers from a business or partnership will not necessarily qualify for business relief.
- Rights under a pension scheme:** a gift may arise if acts or omissions by a member of a pension scheme have the effect of increasing the value of benefits passing outside the member's estate at the expense of their own estate.

Where the information provided about aspects of lifetime transfers are unclear or incomplete, HMRC is more likely to

ask for further information or seek an explanation of what has occurred.

### Nil rate band

The self-employed taxpayer realises they have to keep business records. Likewise, such records should be made for an estate whether it falls below or above the nil rate band. Clearly, incorrectly recorded transfers could place the estate above the nil rate band and cause a need for review and there is planning to be put in place with two nil rate bands.

On lifetime transfers, making or receiving a commercial or family loan can have implications with regard to wills and IHT. Not all loans can be deducted from a person's estate.

It is common for an individual to either loan money or to receive money as a loan and there are complicated rules in notifying HMRC, which decides whether that the loan is allowable as a deduction against the value of the estate or not. In family situations where a loan is made or received, it is often implemented on an informal basis with little or no documentation.

Sections 162 and 164 of the Inheritance Tax Act 1984 broadly provide that a debt is to be valued for IHT purposes on the assumption that the obligation will be discharged and this would include any accrued interest.

The recording position is:

- **IHT403 (gifts and other transfers of value)**  
Use the IHT403 schedule with form IHT400 if the deceased had given away or 'transferred' any assets – such as cash, property or land – during their lifetime.
- **IHT419 (debts owed by the deceased)**  
Use the IHT419 schedule if you have included a deduction on form IHT400 for any loans, overdrafts, or money spent on behalf of the deceased that is to be repaid out of the estate.

### Budget impact

The tax treatment of loans varies between income tax and IHT purposes. For income tax, the purpose of the loan is the factor that decides whether tax is

## Checklist

- Review aspects of estates that you know may give rise to a lifetime transfer.
- Keep good records of gifts and loans for an estate whether it falls below the nil rate band or above.
- Review all loans, whether family or commercial, secured against family assets.
- Ask questions and obtain written information about the movement of monies within a family farming business.
- Review the eligibility of a corporate partner without focusing on the single dimension of short-term income tax and National Insurance without considering agricultural property relief and business property relief.

allowed for the loan interest payable. For IHT purposes, the loan reduces the asset against which it is secured. Such ruling can help with IHT relief by reducing the value of assets that do not attract reliefs via business property relief (BPR), agricultural property relief (APR) and the surviving spouse exemption, that is secure the borrowings against an asset that is otherwise chargeable to IHT.

However, the 2013 Budget has, without advance warning, deemed such sensible arrangements to be a "scheme". The new rules are not open to public consultation and it is hoped that parliamentary committee members will look at the commercial angles before royal assent to the Finance Bill 2013.

All loans, whether family or commercial, secured against family assets must be reviewed as they may cause problems with the calculation of the net estate, the IHT liability and family entitlement. So act now!

Ask questions and obtain written information about the movement of monies within a family farming business. The availability of signed documentation and robust evidence is key, but it is important that this is correctly reflected in contemporaneous paperwork. Research and gathering evidence of findings during life is the most practical way forward. After that 'your best witness is dead' and providing clarity can be difficult.

### Corporate partner

A farming fashion is introducing the corporate partner. With the increased profitability (subject to a year of bad weather), many farmers are looking to the limited company as a way of helping mitigate the onerous burden of the 50 per cent (reducing to 45 per cent) income tax rate and the class 4 National Insurance (NI) liability. Tax mitigation can be achieved by having a limited company as a partner in the farm and timing the dividend extraction correctly.

Separate limited companies have been set up for dealing with the various diversified activities that can make the whole area of trying to claim both BPR and APR on the mixed estate complicated with limited-company interaction. The tax planning cannot just involve the single dimension of short-term income tax and NI without considering APR and BPR.

When the farm is owned by a limited company it should be noted that, under section 122 of the Inheritance Tax Act 1984, only a majority shareholding achieves APR. All minority shareholding of farming companies should be reviewed.

Often, such arrangements can cause lack of clarity between family members and partners about gifts and loans that are required to facilitate such arrangements. They can create loans between businesses that need careful review from a corporation tax and IHT perspective. ■

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