## Business Property: IHT Advantages Of Improvements And Repairs

**Julie Butler** outlines how improving and repairing business property can deliver tax advantages.

**For the average businessman it makes very strong commercial and tax sense to repair and improve business property prior to death.**

The basic principle is that if a businessman dies owning his trade and his trading property, he can qualify for business property relief (BPR) for inheritance tax (IHT) purposes, subject to certain conditions (e.g. as to his period of ownership). Expenditure on the property should achieve income tax or corporation tax relief on the repair element, and future IHT relief.

The recent tribunal cases on repairs of Pratt v HMRC (TC1269) [2011] UKFTT 416 , Hopegear v HMRC (TC 02734) [2013] UKFTT 331 and Cairnsmill Caravan Park v HMRC (TC 02580) [2013] TC 02580 have made repairing parts of the business very attractive for the elderly businessman in terms of income tax relief and overall tax efficiency. The taxpayer can achieve an income tax deduction on the expense incurred, and any monies previously subject to IHT in their estate are moved into a business qualifying for BPR.

If businessmen own assets outside the business that exceed the IHT nil-rate band or, for example, cash on the business balance sheet, they could look to repair and improve the business for IHT efficiency while taking full advantage of these recent repair tax cases. The maximum for annual investment allowance (AIA) claims will reduce on 31 December 2015 from the current allowance of £500,000 to a new permanent maximum of £200,000, as announced in the July 2015 Budget.

### Inheritance tax advantages

Many businessmen will exceed the nil-rate band for IHT purposes, which stands at £325,000 (for 2015/16), with outside investments, excepted assets, etc. Many frugal businessmen are building up cash reserves. Issues such as the benefit of cash reserves and planning for the cost of care in one's twilight years also have to be taken into consideration.

These matters are complex, as also tend to be the Wills of business families. Wills often leave the business to family members who stay in the business operation, and leave the outside investments to other family members. In some cases, family members act dishonestly and use tax efficiency as a smokescreen for manipulation. However, there is no doubt that repair and improvement planning to incorporate capital allowances is very beneficial at the moment, so each case must be looked at on its own merits to ensure that the best result is achieved.

### Repairs and improvements

Money spent to improve the business property will fall into one of the following categories of expenditure:

- repairs (see Pratt, Cairnsmill and Hopegear);
- capital allowances (see the 2014 and 2015 Budget changes, reducing the AIA to £200,000 with effect from 1 January 2016); or
- improvements (capital, which are not deductible for income tax purposes).

The definition of the above categories is something of a grey area, so it is very important to plan the nature of expenditure in advance. If any business project is approached on the basis that all expenditure has to fall into the category of repair, capital allowances or improvement, then the above is the only way to consider how to categorise expenditure. In reality, there would most likely be expenditure arising in each of these categories.

Money spent on improvements can also be very tax–efficient, because it could well be that the businessman has no need to 'roll over' a capital gain for capital gains tax (CGT) purposes. For example, they may have sold part of the business for a development resulting in a capital gain that can be rolled over. So it may be worth reviewing development opportunities and then tax-efficiently repairing and improving the business property.

### Plans for cash expenditure

Many would argue that the question of the cash does not matter, as provided there is a plan for it to be spent on a specific business project it can qualify for IHT relief as part of the business. However, there will probably still be a fight to convince HMRC that this is the case.



Thus, any tax planning around repairs, improvements to buildings, etc., should clearly show that the cash on the balance sheet is to be used on a future project. Should the businessman die before the works are completed or undertaken, there is more chance of achieving IHT relief through BPR on the cash concerned.

Where there is excessive cash, if the surplus monies can all be used for repairs, then this expenditure will qualify for income tax relief, as the money spent will be a tax deductible expense, and the expenditure will also effectively give IHT reliefs, provided that the assets invested into qualify for BPR. Therefore, if there are projects that require money to be spent, it is as well to spend the money.

### Capital allowances control

With an increased ability to claim capital allowances on plant and machinery that is integral to the buildings of the business and thus qualifying as integral features, there are going to be more problems and complications attached to the probate valuation of businesses, and increased need for collaboration between accountants and probate valuers. Historically, the machinery valuation on probate simply related to machinery, but now the valuation includes machinery integrated into buildings and this gives rise to complex considerations.

Whatever the very beneficial tax planning opportunities that exist for elderly businessmen, care must be taken to consider Will disputes and undue influence on decisions.

Where (for example) one family member stays in the business, but others do not stay in the business, problems arise where the family members involved in the business persuade parents to put money into the business to repair and improve property. With the correct structure this could be very tax-efficient, but it could also mean that those family members who are involved in the business have the advantage of the receipt of this money by way of repairs to property held within the business operation. It could be argued that they are persuading family members to push investments across to 'their' side of the trading activities, to the detriment of those not involved in the business.

The recent case of Hart and Samways v Burbidge [2013] EWHC 1628 (Ch) provides a good illustration of how presumed undue influence can impact on many farming Wills in the current farming situation. The problem is made more acute by how much farm values have increased in comparison with outside investments.

In the context of farming, the question has to be asked, when the farmer is being encouraged to spend more and more on the farm by the sibling who inherits the farm, is legal advice being obtained? The case of Burbidge shows it is necessary for the court to be satisfied that the advice and explanation by a solicitor was effective to free the donor from the impairment of influence on his free will. The sibling who has nothing or a considerably reduced sum left to inherit needs protection.

### Undue influence

The Burbidge case is a good illustration of the factors that will lead the court to determine that undue influence has taken place, even where there has been no deliberate wrongdoing on the part of the person considered to have exerted the influence.

- The case involved two brothers claiming their sister (Susan) had exerted undue influence over their mother, causing them to lose out on their inheritance.
- The court held it was the daughter's duty to prove there was no undue influence and she failed to do so.
- While there was no evidence of actual undue influence, there was a relationship of trust and confidence between mother and daughter, which gave rise to presumed undue influence.

The judge absolved Susan of any deliberate wrongdoing, but emphasised that undue influence can still exist in those circumstances, and relief can still be granted to undo the transactions procured by it.

### Practical Tips:

- Review opportunities to repair and improve business property, as they can have income tax and inheritance tax advantages.
- Consider the cash reserves of businesses, and ensure clear notes and strategies of potential ways for the reserves to be spent.
- Consider both cash reserves and opportunities for repairs and improvements in conjunction with one another.
- If an elderly businessman is diminishing his own outside investments which would otherwise have been left to one child, to improve business property which would be left to another, then there has to be consideration of the legal implications and the potential need for legal advice.