

# The tax advantage of building on land

**Julie Butler F.C.A.**

Butler & Co, United Kingdom

A recent case before the Special Commissioners provides hope that where tax law is not so clearly defined it is always worth a “fight” with HMRC to try and benefit the taxpayer. The subject matter was a taxpayer being “landed with various unsaleable interests” which in the current property market might apply to a number of clients now and in the future (*DWC Piercy’s Executors v HMRC* [2008] Sp C 687 (June 2008)). Land that is let out can continue to qualify as trading stock.

**T**he deceased, Mr David Piercy, had been the managing director and the major shareholder of a trading and property development company, Temple Lodge Limited. The Company had developed and sold 256 flats in North London between the 1950’s and the early 1970’s. In the 1970’s, the nature of the trade moved into the activity of small community shopping centre developments. The key here is developments.

However, one development ran into problems regarding planning permission (everyone can sympathise with that) so as a temporary measure the company constructed low quality industrial workshops and let them on short-term leases. The idea was that the workshops would be demolished when the development could achieve planning permission and could go ahead.

HMRC held that the business property relief (BPR) under the Inheritance Tax Act 1984 (“IHTA”), section 105(3), would not apply to the deceased’s shares in the company as the business was the making or holding of investments.

## I. Significant receipt of rents

Part of HMRC’s grounds for rejecting the claim for BPR was that Temple Lodge Limited received significant rental income.

The Executors appealed on the grounds that Temple Lodge Limited still wished to develop the land in North London for residential purposes, but had been unable to do so because of uncertainty about proposals for a new railway line.

## II. The holding of trading stock

The Special Commissioner accepted evidence presented by the Executors and allowed the appeal, finding that the company continued to hold its land as trading stock and ruled that it was not an investment company for the purposes of section 105 of the IHTA 1984. The Special Commissioner also held that the only type of land-dealing company whose shares fail to qualify for the relief is some sort of dealing or speculative trader that does not actively develop or actually build on land. The Special Commissioner also noted that if a company is to be said to be conducting the business of holding investments, then the company must actually have some investments; in this case the company held land as trading stock.

## III. Land developer v land dealing company

The Special Commissioner held that a company, such as Temple Lodge Limited, which acquired land with a view to developing it was not a land dealing company. A company whose land was stock did not thereby hold investments and if a company did not hold

Julie Butler F.C.A. is a partner at Butler & Co and is based in Hampshire.

investments, its business could not be said to be one of holding investments. The Company in this case had never bought land as an investment. It was not an investment company.

#### **IV. To actively develop or build on land compared to a "land dealing company"**

It is worth quoting the Special Commissioner Howard M Nowlan here:

"Firstly I should mention a point on the interpretation on section 105(3) IHTA 1984 that, if ignored, could lead to some confusion. Section 105(3) states that: 'Shares in a company, are not relevant business property if the business carried on by the company consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments'."

#### **V. Building v dealing**

The Special Commissioner continues:

"This subsection provides that shares in two categories of company that hold land do not qualify for the business property exemption, those two categories of company being 'land dealing companies' and 'companies making or holding investments [in land]'. The point that I should clarify is that it has long been accepted that a building company (that generally of course buys land, builds on it, and sells it off in a trading or dealing manner) is not for this purpose 'a land dealing company'. Equally it follows from that fact that the Respondents have specifically confirmed that they are not contending here that the company was, at the date of the relevant death, a 'land dealing company', that a company whose business it is to acquire land with a view to promoting a development, and then realising the developed land once sub-contracted building work has been completed, is also not a 'land dealing company' for the purposes of the section 105(3) definition. The only type of land dealing company whose shares fail to qualify for the relief is thus some sort of dealing or speculative trader that does not actively develop or actually build on land. At no stage in this case was it contended that the shares in the company here forfeited business property relief on this alternative ground. The only question was accordingly whether the company was, at the date of death 'a company whose business consisted wholly or mainly in the making or holding of investments'."

#### **VI. "The company must have got some investments"**

The Special Commissioner concludes:

"The other point that I should make is both a general legal point and one embedded in Income Tax and Capital Gains Tax law. This is the seemingly obvious proposition that if a company is to be said to be conducting the business of holding investments, then the company must have got some investments. The reason why this appeal fails is that on the facts and evidence of Michael Piercy, I conclude that this company had no investments."

#### **VII. Motives geared to protecting and eventually later realising future development potential**

It is again worth quoting the Special Commissioner:

"It therefore seems to me that, reverting to the two possible rationales for retention of properties, with the resultant significant receipt of rents, the explanation lies far more in the sphere of various motives geared to protecting and eventually later realising future development potential, rather than the alternative explanation of the company simply being 'landed with various unsaleable interests' such that various residues of developments had to be let. In the light of this and because I consider that the first explanation is utterly inconsistent with any contention that the properties were appropriated from stock to investment, my decision is that this company held none of its properties as investments. And as I have already said, the rather self-evident point is then that a company with stock, but not investments, can hardly be treated as conducting the business of acquiring and holding investments."

#### **VIII. Proactive protection for clients**

The proactive tax advisor has to consider a vast scope for Inheritance Tax (IHT) planning and protection. The cynical observer could possibly comment that as the commercial property market has collapsed so significantly then so has the potential IHT bill in direction with the fall in value but protection is still required.

Clearly the activity of building and property development are very different from holding investment land or trading in investment land but circumstances can lead to a potential development site being held longer than required.

If the death of the shareholder, sole trader, partner, etc. should sadly intervene then it is likely that HMRC will challenge the claim for BPR. The taxpayer and adviser must ensure the correct and clear treatment of trading stock.

#### **IX. "Trading stock" not "land held as an investment" on the balance sheet**

In the current property climate where it can be difficult to sell potential development land and therefore it has to be let out, one must ensure the asset is always correctly shown as stock not an investment in the balance sheet. Obviously where the Special Commissioner's question "motive" there must also be a review of company/partnership minutes to ensure that the motive to build and develop is reflected.

#### **X. Action plan**

Review the balance sheets and minutes of every property trading/building business and ensure the correct treatment of stock. Review all contemporaneous correspondence, e.g. dealing with the bank for loans to support the difficult position to ensure the motive.

Discuss with client and take robust notes!

*For further information, please contact the author by email at: [j.butler@butler-co.co.uk](mailto:j.butler@butler-co.co.uk). Website: <http://www.butler-co.co.uk>*