



TIME TO PLAN

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Time is ticking for tax advisers to absorb new rules on loans for inheritance tax and plan for the survival of the farming community, says **Julie Butler**





In calculating Inheritance Tax (IHT) liabilities, relief for loans and debts have been available in a very favourable order of set-off for businesses. In principle it was possible to secure maximum IHT relief by securing business loans against non-business assets, ie against private assets. It was then possible to obtain Business Property Relief (BPR), Agricultural Property Relief (APR) or Woodland Deferral Relief on the whole of the business assets and the private assets were reduced by the loans, thus saving IHT. For IHT purposes it is necessary to determine which asset has its value reduced by a loan debt. It is generally the asset against which the debt has been charged or secured which might not have been the asset the loan was used to obtain. The Budget 2013 proposed a radical change to this advantageous treatment and the farming industry has possibly been the worst hit.

An example of such a structure would be where a family business took out a loan to help the trading operation which is secured against the family home. The full BPR and APR was therefore claimed against the business/agricultural assets. IHT that is payable on the family home on death was therefore reduced. Many employees set a target of being 'debt free' when they retire and, above all, being free of debt when they die, but in business there is often not that luxury available. Loans are often needed to keep the business going and sometimes to survive. It can be argued this is especially true with farming operations that have high land values and considerable work in progress. The fact that the change in the Budget has been described as an 'anti-avoidance measure' has caused some concern as so many businesses have negotiated loans in this way purely to meet the requirements of the bank.

LOANS TAKEN OUT AFTER 5 APRIL 2013

Many farms and farm advisers will be pleased to hear that the latest provisions in the Finance Bill have been adjusted and restricted only to loans taken out after 5 April 2013. The result is a very short space of time for tax advisers, businessmen and farmers to absorb the information and, above all, plan for the survival of the farming empire. Lobbying had begun in earnest. The clause in the 2013 Budget was approved but it will not now apply to loans in existence prior to 6 April 2013. It is understood the new provisions will not affect

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someone who took out a business loan in the past secured against their non-business assets. The pre-April 2013 exemption will not apply if the terms of the loans are subsequently amended.

When dealing with business and farming operations, as part of simple IHT planning but also as part of commercial consideration, it has been deemed to be good practice to secure loans against assets owned by the farmer/landowner which do not achieve IHT relief or do not achieve maximum reliefs. The Budget announcement was considered to be a broad brush approach which would be damaging to the succession of some working farms that need to be able to use this IHT planning technique for the next generation to continue the business.

NO ADVANCE WARNING

The type of planning to avoid IHT through offset against private assets has been well-used and it is now regarded as 'abusive' by HMRC. There had been no advance warning of these proposed restrictions. Farming organisations approached MPs seeking their support for genuine commercial arrangements. The result has been to make the change from 6 April 2013. Schedule 34 of the Finance Bill attempted to remedy the 'abuse' (as it has been called).

THE FUTURE IHT POSITION OF LOANS

If a debt is incurred to finance the acquisition, maintenance or enhancement of an asset which attracts APR, BPR or Woodland Deferral Relief, Schedule 34 requires the liability to be taken to reduce the value of the property with the benefit of the relief – not as a debt against the remaining taxable estate. This change was due to include existing arrangements but now only applies to those loans taken out from 5 April 2013.

The restrictions to Schedule 34 that were proposed were as follows:

- A deduction for a liability will only be allowed to reduce the IHT liability to the extent that it is repaid to the creditor, unless it is shown that there is a commercial reason for not repaying the liability and it is not left unpaid as part of arrangements to obtain a tax advantage. This will prevent relief for any debts that are waived or forgiven sometimes after the date of death.
- No deduction will be allowed for a liability to the extent that it has been incurred directly or



indirectly to acquire property which is excluded from the charge to IHT. This is unless the property has since been disposed of or where the liability is greater than the value of the excluded property.

- Where the debt has been incurred to acquire assets on which an IHT relief such as BPR, APR and woodlands relief is due, the debt will reduce the value of the assets that qualify for IHT relief. Any excess liability over the value of the farm assets qualifying for IHT relief will be allowable as a deduction against the estate in general, subject to the new rule about unpaid debts as mentioned.
- Mixed liabilities – a further restriction applies where funds or loans are used for multiple purposes and are then partly repaid. In these cases, the liabilities attributable partly to overseas or relievable assets will be treated as repaid first on the relievable related liabilities.

The Bill explained that the provisions were designed ‘to remove the tax advantage that is achieved by arrangements which exploit the current provisions’. It is understood that the new rules will also apply to trusts, except the unpaid liabilities rule will not apply when calculating the estate value for the purposes of the ten-year anniversary charge.

PRACTICAL PLANNING

Much IHT planning will have to be revisited but, as has been set out, a lot of the security for the farms arose through simple practical commercial drivers but nevertheless all business loans should be reviewed.

All business loans and the accounts in which they are reflected must be reviewed as soon as possible. Permanent files should be scrutinised for the original loan documentation and working papers must be followed to check what assets the loan was used to purchase. In future the trail for all loans, eg conveyancing documents etc and the loan agreement will need to be readily available. A future practical planning action point to consider might be the possible selling of assets not attracting IHT reliefs and then not taking out new loans. Such action would mean that the IHT liability should be unchanged. However, the capital gains tax (CGT) implications will have to be considered and weighed against commercial

PRACTICAL ACTION POINTS

- Review all old loan agreements and ensure the documentation is held on file to be able to prove the loan was in existence before 5 April 2013.
- Be very careful about taking out new business loans and consider the IHT implications post 5 April 2013.
- If a loan is going to be amended extra consideration and planning needs to be undertaken.
- Change approach to IHT planning and loans. Consider selling non-business assets to fund capital needs.



HMRC is taking aim at salaried members of LLPs but proposals may have to be toned down

Partnerships under attack

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(and emotional) considerations of private assets. So often these assets are needed as “farming buffers” to help farmers when times are hard and no-one knows what the CAP Reform 2013 will bring with regard to the quantum of the subsidies and the impact on farming profits.

For new arrangements going forward, it may be possible to ensure that personal monies are used to acquire assets qualifying for IHT relief so that borrowed money is used to acquire other assets. Those who structured their affairs long before this new rule was ever thought of will now escape the accusation of ‘abuse’ but they will have to prove the date of the loan.

POST 6 APRIL 2013

Obviously lobbying and strong presentation of arguments have been undertaken. Commercial disadvantages of this announcement at short notice were presented. This article is aimed at awareness as it appears that this is a subject that did not ‘set light to the anticipated business bonfires’ so soon after the 2013 Budget as might have been anticipated. Many other areas of the business angles of Budget 2013 caused much more concern, eg, mixed partnerships consultation and the impact that will have on corporate partners.

Farms require huge investment of capital which, in turn, need large borrowings. The existing arrangement was not a scheme but a practical, commercial approach to ensure farms and business could pass down to the next generation without extra IHT causing problems.



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