

## Briefing Note

Inheritance Tax Planning

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### The Brander Case (HMRC v Brander (Executor of the 4th Earl of Balfour)) – Succession Planning

This important inheritance tax (IHT) decision remains very relevant for estate owners.

#### Background

Business property relief (BPR) is available on qualifying business interests, and effectively wholly exempts the qualifying business from IHT. To qualify, it must be shown that the business in question is mainly a trading enterprise, not carrying on investment activities. HM Revenue & Customs (HMRC) considers that letting is an investment activity, whereas in-hand farming and forestry will be trading.

The late Lord Balfour died in 2003 owning Whittingehame Estate, which comprised around 2,000 acres of farm land (approximately half let and half occupied for in-hand farming), the main house, woodlands and 23 let houses and cottages. Looked at on their own, the let properties would not qualify for BPR. However, the Executor claimed BPR on the let houses and cottages on the basis that they were managed as part of a larger estate management business, and that larger business was wholly or mainly a trading business. This claim followed precedent laid out in the earlier case of Farmer.

#### HMRC initially denied the relief, arguing:

- (a) First, that there were in fact two businesses carried on at Whittingehame, being a letting business in connection with the let farms and the let houses/cottages, and a farming business. The letting business, standing on its own, could not qualify for BPR, as it would be regarded as an investment activity.
- (b) Second, if the two activities (i.e. letting and farming) could be regarded as one business, then that single business was mainly an investment business, so that, again, BPR could not apply.

#### First-tier Decision

The First-tier Tax Tribunal ruled that there was indeed only one business (that of estate management) carried on at Whittingehame Estate by the late Lord Balfour, and this business was not mainly an investment business. Business property relief should, therefore, be allowed on the whole value of the let houses and cottages.

#### Decision of the Upper-Tier Tribunal

HMRC appealed against this ruling, again arguing that either there were two separate businesses being carried on at Whittingehame (i.e. farming on the one hand, and letting properties on the other), or, if there was only one business, it was mainly an investment business.

The HMRC arguments were wholly rejected. A number of points can be drawn from the combined decisions of the First-tier and Upper-tier Tribunal decisions. These points will be of considerable importance to all estate owners and their advisers in IHT planning.

(a) **What is the Business for BPR Purposes?**

Landed estates are complex. The ownership of the estate may be divided (e.g. between individuals and family trusts) and different activities on the estate may be carried out through different vehicles (e.g. a sole tradership, a partnership, a company or a combination). It is necessary to analyse carefully the existing arrangements in each case to identify what business (or businesses) are being carried on. If the let houses and cottages on the estate are managed either separately from the trading activities, or within a structure where letting is the predominant activity, then BPR will not be available on those let properties. This is regardless of how active the management of the lettings is.

(b) **Is there a Single Business?**

In determining whether there is one single estate business or two separate businesses, one letting and one trading, the Tribunal confirmed that the method of financial bookkeeping is not the predominant test, but rather one should look at whether there was any “inter-connection, any inter-lacing, any inter-dependence, any unity at all embracing those two businesses”. The Tribunal rejected the arguments from HMRC that the existence of separate financial accounts for the farming and letting activities meant there was inevitably two businesses.

(c) **Is the Business Mainly an Investment Business?**

The question “Does an estate management business consist mainly of holding investments?” is to be answered by looking at the business in the round, and comparing the relative importance to the business as a whole of the investment and non-investment activities. This involves looking at the business over a period of time and having regard to various factors, such as the overall context of the business, the turnover and profitability of the various activities, the activities of employees and other persons engaged to assist in the business, the acreage of the land dedicated to each activity and the capital value of that acreage.

No one of these factors is conclusive, and whilst all relevant factors should be considered, there may be circumstances in which a factor which is relevant to one business is not relevant to another, and so would be given less weight.

(d) **What Activities are Non-Investment?**

The Tribunal confirmed that in-hand farming was a trading activity even though it was managed on a contracting basis. Woodland management was also regarded as trading. In addition, although on Whittingehame Estate the sporting activities generated little income, they were combined with vermin control throughout the Estate and, therefore, were considered to be on the non-investment side of the business.

(e) **Financial Factors**

So far as turnover and net profit are concerned, the comparison between the trading and non-trading activities should be considered over a period of time. During the period reviewed, trading turnover exceeded letting turnover in every year. Net trading profit exceeded net letting profit in all but 2 years. On this basis, the Upper-tier Tribunal confirmed that those factors strongly supported the conclusion that Whittingehame Estate was mainly a trading business.

(f) **Management and Labour Time**

Time spent by management and employees in the business is also a relevant factor. HMRC had argued that only management time should be taken into account. The Tribunal held that it was appropriate to take into account the time spent by contractors farming the in-hand land as well as the time spent by the land agents in the management of those farms and forestry.

(g) **How important are Capital Values?**

At Whittingehame, the capital values of the let properties (the farm land, cottages and houses), totalled around £4.35m, compared to the value of the in-hand properties of £2.3m. The Tribunal recognised that, other things being equal, this factor pointed to some degree towards the business being regarded as principally an investment activity.

However, the Tribunal held that on an estate such as Whittingehame, where the long term policy was to retain land, market values were generally immaterial to Lord Balfour's business decisions, and, therefore, little weight should be attached to capital values in determining where the overall business was predominantly trading or investment based.

## Conclusion

This case provides considerable assistance to estate owners and their advisers in identifying whether or not it may be possible to obtain business property relief on significant let residential portfolios within a landed estate. It will be necessary to review present business arrangements and structures in light of this decision to establish whether matters are structured appropriately or if any steps should be taken to improve the availability of relief. The opportunity of obtaining full IHT shelter for valuable housing stock is too important for any estate owner to overlook.

If you would like more information or advice on the matters covered in this briefing note, please speak to either your usual Turcan Connell contact or Ian Clark, one of our Tax and Succession Partners on 0131 228 8111.

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