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CAAV NATIONAL TUTORIAL 2024

CAPITAL TAXATION

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DETAILED NOTES

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INHERITANCE TAX

1 THE CHARGE TO TAX

1.1 Chargeable transfers

IHT is charged on a *chargeable transfer* (IHTA 1984, s.1), which is defined as a *transfer of value* made by an individual, which is not an *exempt transfer* (s.2(1)).

1.2 Transfers of value

A transfer of value is a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition (s.3(1)) - the net loss to the estate of the transferor is the value transferred.

1.3 Dispositions

The word *disposition* is not defined for IHT purposes and so should be attributed its wide ordinary and natural meaning. It would include all forms of transfers of money, tangible assets and rights in properties. A disposition includes a lifetime gift (to an individual or to a trust). It can also include a sale of a property at an undervalue. For example, where a father sells a house worth £250,000 to his son for £100,000, the loss to his estate is £150,000.

1.4 Dispositions that are not transfers of value

Certain transactions, although dispositions, are not treated as transfers of value, and are therefore outside the scope of IHT. They include:

1.4.1 A bad commercial bargain in a transaction with an unconnected party (s.10). A genuine sale at a price which turns out to have been too low or a purchase at a price which turns out to be too high does not give rise to IHT even though it results in a loss to the seller's estate.

1.4.2 The grant of a tenancy of agricultural property is not a transfer of value if the grant is for full consideration in money or money's worth (s.16).

1.5 Exempt transfers

Certain transfers of value are exempt and are therefore never charged to IHT, including:

1.5.1 Each individual has an annual exemption of £3,000. Unused exemptions may be carried forward one tax year only (s.19(1)).

1.5.2 The lifetime transfer of value is exempt if it constitutes normal expenditure out of income, namely the gift is part of the normal expenditure of the transferor; is made out of his after-

tax income; and, after allowing for all other transfers of value forming part of his normal expenditure, the transferor is left with sufficient income to maintain his usual standard of living (s.21(1)).

1.5.3 Any transfer of value made during life or on death to the transferor's spouse or civil partner is exempt provided both have matching domiciles (s.18).

1.5.4 Outright gifts to charities and settlements on charitable trusts are exempt transfers (s.23).

1.5.5 Small gifts (£250 or less) (s.20).

1.5.6 Gifts in consideration of marriage - £1,000 from any person, £2,500 from a grandparent or more remote ancestor or party to the marriage and £5,000 from a parent (s.22).

2 RATES OF TAX (2024/25)

For chargeable transfers after 5 April 2010 (husband and wife treated separately)

On the first £325,000	Nil
Above £325,000 threshold	20% (lifetime transfers)
	40% (transfers on death)

Note: for deaths occurring on or after 6 April 2012 a reduced rate of 36% will apply where a deceased individual has left 10% or more of their net estate to charity. Also, unused proportion of nil rate band can be transferred to surviving spouse or civil partner.

For deaths on or after 6 April 2017, the residence IHT nil rate band (RNRB) now applies when a residence is passed on death to direct descendants.

The RNRB was:

£100,000 in 2017/18;

£125,000 in 2018/19; and

£150,000 in 2019/20.

The RNRB has been at its current rate of £175,000 since 2020/21.

Following the Finance Act 2021, the RNRB will be frozen at £175,000 until at least April 2028.

The RNRB is available where:

- a person dies on or after 6 April 2017;
- their estate included an interest in a dwelling house that was a person's residence at a time when the person's estate included that dwelling house or any other interest in the dwelling house (a qualifying residential interest (QRI)); and
- the QRI was inherited by a lineal descendent – this includes step-children, adopted children and foster children including their lineal descendants. It also includes a lineal descendant's spouse or civil partner.

The gift of a QRI to a trust in a Will will qualify for the RNRB if the trust is:

- an immediate post death interest under which the lineal descendent has an interest in possession;
- a disabled person's trust;
- an 18 to 25 trust; or
- a trust for bereaved minors.

It will not apply to a gift to a discretionary trust, although there is nothing preventing the trustees exercising their powers to appoint the property out to a lineal descendent within 2 years of death and relying on s144 IHTA 1984 to write the gift back into the will for inheritance tax purposes.

The RNRB is transferable in the same way as the ordinary nil rate band – an unused proportion of the RNRB can be transferred to the surviving spouse or civil partner. The surviving spouse can claim this additional RNRB even if their pre-deceased spouse did not own a QRI at their death.

There is a tapered withdrawal of the RNRB for estates worth £2 million or more. Property qualifying for APR and/or BR is included in the value of an estate for the purpose of the taper threshold.

An additional "downsizing amount" can be claimed where the deceased downsized from a more valuable property or ceased to own residential property altogether on or after 8 July 2015 and some part of the estate, apart from a residential property interest, is inherited by a lineal descendant. For example, James and Janet own a property worth £350,000 but in their 70s they downsize to a much smaller apartment valued at the time of Janet's death at £200,000. Janet's executors are in effect able to carry forward the RNRB from the previously owned (more expensive) property for the purpose of the downsizing addition, ensuring that the RNRB is available in full on Janet's estate.

3 LIFETIME GIFTS

3.1 Potentially exempt transfers

A potentially exempt transfer ("PET") is a transfer of value which gives rise to no tax liability when made, but becomes a chargeable transfer if the transferor dies within the following 7 years. When this happens the donee has the primary responsibility to pay the IHT due.

A PET will normally be a gift from one individual to another outright.

The tax on a PET which has become chargeable as a result of the death of the donor within 7 years after the gift *is reduced* if the gift was made more than 3 years before the death. After 3 years the rate of IHT starts tapering by 20% each year.

3.2 Chargeable lifetime transfers

Except in very limited circumstances a gift to a trust will be a chargeable lifetime transfer (CLT). CLTs give rise to an immediate charge to IHT at one half of the full death rate, i.e. 20%, to the extent that the value of the gift exceeds the nil rate band of the settlor.

The nil rate band (currently £325,000) is reduced by the aggregate of CLTs made during the previous 7 years. If the settlor dies within 7 years after the CLT there may be a further charge at the death rate applicable at that date with credit given for the lifetime tax, if any, already paid.

4 TRANSFERS ON DEATH

4.1 Death estate

On the death of a person, IHT is charged as if he had made a transfer of value of his *estate* immediately before his death (s.4(1)).

"Estate" means all the property which the deceased owned (his *free estate*) and any property which he is deemed to have owned, namely property held in certain life interest trusts (see below).

4.2 Less liabilities

Debts and other liabilities incurred by the deceased during his lifetime are deducted from chargeable assets in arriving at the value of his estate (s.5(3)). The manner in which liabilities are deducted from chargeable assets is determined by the following rules.

4.2.1 Liabilities secured on a specific asset are treated as reducing the value of that asset.

4.2.2 Foreign liabilities are deducted from properties situated outside the UK.

4.2.3 All other liabilities are deducted from the aggregate value of the chargeable assets.

4.3 Less reliefs

Applicable reliefs are deducted, e.g. business relief and agricultural property relief. See below.

4.4 Gifts with reservation

The deceased is treated as having continued to own property that he gave away during his lifetime (after 17 March 1986) if:

4.4.1 possession and enjoyment of the property was not assumed by the donee at the time the gift was made or

4.4.2 the property was not enjoyed to the entire, or virtually the entire exclusion of the donor.

5 IHT ON CERTAIN LIFE INTEREST TRUSTS

5.1 Where a beneficiary is entitled to receive the income from the trust property (commonly described as a "life interest"), he may be deemed to own the trust property for IHT purposes (s.49(1)). This will be the case with:

5.1.1 all life interests in lifetime settlements or Will trusts that commenced before 22 March 2006 and;

5.1.2 life interests under Will trusts commencing on or after that date.

5.2 IHT is chargeable when the life interest comes to an end:

5.2.1 when the beneficiary dies the value of the trust fund is included in his estate;

5.2.2 when another beneficiary becomes entitled to the income the original beneficiary is treated as making a gift, which, as a rule, will be a PET if another beneficiary becomes entitled to the capital at the same time or a CLT if the trust property remains in trust.

6 IHT ON RELEVANT PROPERTY TRUSTS

6.1 Trusts other than certain life interest trusts, whose tax treatment is summarised above, are subject to the *relevant property* charging regime. They are subject to

6.1.1 an IHT charge of up to 6% on the value of the trust property every tenth anniversary, and

6.1.2 an exit charge of up to 6% on the value of property distributed to beneficiaries between ten-year anniversaries.

6.2 Reliefs that apply to agricultural and business property apply in relation to relevant property charges.

7 VALUATION

7.1 Open market value

IHT is computed by reference to the open market value of property. This is defined as the price which the property might reasonably be expected to fetch if sold in the open market (s.160).

7.2 Special rules

The following special rules apply:

7.2.1 No reduction is made merely because the price would be depressed if all the property were to be sold at the same time.

7.2.2 The deceased's death is taken into account in arriving at a value, and this may result in a higher or lower price than would have been achieved on a lifetime sale. For example, the value of an expert's business could be depressed if the goodwill was primarily attributable to his personal expertise.

7.2.3 Property is assumed to be sold in the manner which produces the best price, i.e. as a whole or in lots.

7.3 Related property

The value of a property in a person's estate must take into account certain *related property* if that results in a higher value (s162). Related property includes property held by his spouse or civil partner; and trust property in which his spouse or civil partner has a qualifying life interest. For example, if husband and wife each has a minority shareholding in a family company, but the shares together would amount to a majority interest, then the value of each spouse's shares will include a proportion of the uplift in value if their holdings were combined. The rule captures any attempt to break up a set of objects which as a set are more valuable than the sum of the objects valued individually (e.g. a pair of antique candlesticks).

7.4 **Jointly held property**

The value of jointly owned property is usually split between the owners in accordance with their percentage share. A percentage interest in land is normally worth less than the equivalent proportion of the value of the property as a whole. For example, the value of a half share of land is vacant possession value less a discount to reflect the restricted demand for this type of interest. On a death, the customary deduction is 15% where the deceased had the right to occupy the land in question, and otherwise 10%.

7.5 **Agricultural value**

The open market value of agricultural property may exceed its agricultural value where the property has planning permission or there is development, amenity or mineral value (e.g. gravel extraction potential). This is relevant when considering the application of agricultural property relief, which applies only to agricultural value, and business relief, which applies to the whole value.

7.6 **Substituted sale value**

Where an interest in land in a person's estate is sold within three years of the date of death, the sale value may be substituted for the value on death (s.191).

8 BUSINESS RELIEF (FORMERLY BUSINESS PROPERTY RELIEF)

To the extent that a transfer of value includes *relevant business property,* the value transferred is reduced by a percentage. The percentage reduction, currently 100% or 50%, is known as business relief ("BR")[1].

There must be a *qualifying business*, the asset must be *relevant business property* and have been owned for a minimum period.

8.1 **A qualifying business**

"Business" includes a business carried on in the exercise of a profession or vocation but not a business carried on *otherwise than for gain* (s.103(3)).

A business or interest in a business, or shares or securities of a company, do not qualify if the business (or the business of the company) consists *wholly or mainly* of dealing in securities, stock or shares, land or buildings or making or *holding investments* (s.105(3)).

8.2 **Relevant business property**

The categories of relevant business property eligible for BR, and their respective rates of relief, are listed in s.105. They are:

8.2.1 a business carried on by a sole trader, or an interest in a business (e.g. a share in a partnership) - 100%;

8.2.2 unquoted securities of a company giving the transferor control - 100%;

8.2.3 any unquoted shares (including AIM shares) - 100%;

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[1] It is still common for many tax professionals to refer to Business Relief as Business Property Relief/BPR.

8.2.4 quoted securities or shares where the transferor controls the company - 50%;

8.2.5 land, buildings, plant or machinery used wholly or mainly for the purpose of a business carried on by a company which the transferor controls, or by a partnership in which he is a partner - 50%; and

8.2.6 land, buildings, plant or machinery used wholly or mainly for the purposes of a business carried on by the transferor being settled property in which he was then entitled to an interest in possession - 50%.

A holding of shares gives a person control of a company if it gives him control of the majority of the voting powers on all questions affecting the company as a whole (s.269). For this purpose account is taken of related property and settled property in which the transferor (or spouse or civil partner) has a qualifying interest in possession, so if husband owns 40% of the voting shares and wife owns 30% of the voting shares, both will be treated as controlling shareholders.

8.3 Minimum ownership period

The property must meet one or other of the following conditions in order to be treated as relevant business property:

8.3.1 it must have been owned by the transferor throughout the 2 year period prior to the transfer (s.106); or

8.3.2 it must have replaced other relevant business property and the combined period of ownership must amount to at least 2 out of the 5 years prior to the transfer (s.107).

Property inherited on the death of a spouse/civil partner is deemed to be acquired on the date when the deceased spouse/civil partner acquired it (s.108). Property inherited in other circumstances is deemed to be acquired at the date of death.

8.4 Business liabilities

BR applies to the value of the assets used in the business (including goodwill) reduced by the aggregate amount of any liabilities incurred for the purposes of the business, i.e. the net value of the business (s.110).

Note however that the Finance Act 2013 introduced new provisions (contained in S.162B of the IHTA 1984) reducing the ability to deduct liabilities in certain circumstances. When liabilities e.g. mortgages are incurred from 6 April 2013 onwards to acquire, maintain or enhance relievable property (e.g. business or agricultural property) the relief cannot be obtained twice. So even if it is secured on non-relievable property the debt will be used to reduce the value of the assets that qualify for relief.

8.5 The "*wholly or mainly*" test – s.105(3)

No relief is available if the business concerned, whether a sole trade, partnership or company, consists "wholly or mainly" of dealing in securities, stocks or shares, or dealing in land or buildings, or making or holding investments.

It may not be clear whether the business activity concerned amounts to a trade or an investment. This is illustrated by the case *McCall & Keenan as Personal Representatives of Eileen McClean v Revenue and Customs Commissioners* [2009] NICA 12. The case concerned the availability of BR on 33 acres of agricultural land, which as a result of planning permission had an open market value far in excess of its agricultural value. In the years before the elderly owner's death, the land had been

let to graziers under a series of *conacre* agreements. It was accepted that the owner had been in occupation of the land throughout and carrying on a business. However, the activities of the owner were limited to the necessary maintenance work of preparing and maintaining fences, watercourses etc. - the grazier, not the landowner, fertilised the land – were not substantial enough to amount to a business distinct from just holding land and making it available to the grazier. Looked at in the round, the business was mainly an *investment* business.

Where a business comprises a mixture of trading and investment activities, the *wholly or mainly* test is applied on an "all or nothing" basis. If a business consists of trading and investment activities (a classic case is a diversified farming enterprise that includes the letting of cottages) if the investment activities outweigh the trading activities, relief is denied on the whole business, including the trading elements. Equally, if it is the other way about, the investment elements will qualify for relief. A decision whether to operate different business activities separately or together is therefore a crucial one.

The Court's approach to the application of the "wholly or mainly" test of s.105 (3) to mixed businesses is illustrated in *Executors of Farmer deceased v IRC* [1999] STC (SCD) 321. In that case it was accepted at the outset that there was a single composite business comprising farming (i.e. a trade) and the letting of farm buildings that no longer had an agricultural use. The Special Commissioner, basing his decision on earlier cases, held that it was necessary to consider all the factors listed below and then look at the business and its activities *"in the round".* The relevant factors - which had to be considered over a period of time rather than at a particular moment - were as follows:

8.5.1 the overall context of the business, (most of the land was used for farming and the lettings were subsidiary to this and of short duration);

8.5.2 the value of the capital employed in the farming and letting parts of the business respectively;

8.5.3 The time spent by the employees and consultants in the respective parts of the business;

8.5.4 the levels of turnover of the respective parts of the business; and

8.5.5 the net profits of the respective parts of the business.

BR was allowed even though the lettings were more profitable than the pure farming because the other four factors supported the conclusion that the business consisted mainly of farming.

Whether a mixed agricultural estate was a non-investment business was considered in *Brander (representative of James (deceased), Fourth Earl of Balfour) v Revenue and Customs Commissioners* [2009] UKFTT 101 (TC), [2009] 374. The Earl had managed the Whittingehame Estate as a single business, comprising the trading activities of farming, forestry and woodland management and sporting activities on the one hand, and the letting of farms, cottages and other buildings on the other. The tribunal had to decide where the preponderance of activity lay having regard to turnover, profitability, underlying market values and time spent in the trading and investment sides respectively of the business. The trading turnover and net profit exceeded that of the letting activities over the 7 years leading up to the Earl's death. Without being able to make a precise quantitative assessment of time spent on each set of activities the figures available pointed to a preponderance on the trading side, including spent by consultants in the last two years – 79% and 78% respectively. The capital value of let properties exceeded that of other properties by 1.88:1, but the Court decided that little comparative weight was to be given to this because the long-term policy of the Estate was to retain land so that market values were generally immaterial to business decisions.

The case of *Pawson (Deceased) v Revenue and Customs Commissioners* [2013] UKUT 50 (TCC) has suggested that holiday lettings are unlikely to be considered anything other than investments. The test applied was to analyse the nature and purpose of the activity to see whether, taken as a whole, it was ancillary to holding an investment or whether it could be regarded as something that had a purpose beyond investment so that it might outweigh any investment element. This is a qualitative, not quantitative, test. It was considered that various activities such as providing cleaners, heating, TVs, telephones and welcome packs were not sufficient to prevent the business from being mainly one of holding an investment. *Green v Revenue and Customs Commissioners* [2015] UKFTT 334 (TC) followed *Pawson*, making it difficult to prove holiday lettings are anything other than investments. *Green* distinguished *Balfour*, as *Balfour* involved a landed estate with a number of different trading and investment activities whereas *Pawson* was predominantly holiday lettings. There is therefore greater scope for arguing that a business is mainly non-investment where it consists of diverse activities.

The First Tier Tribunal case of *Ross V HMRC (2017) UKFTT 0507* denied relief to eight holiday cottages held in a holiday letting business partnership even where "higher level services" more akin to a hotel could be provided to guests from a hotel which had formerly been part of the business. Each case will depend on the level of services provided but the First Tier Tribunal case of *Personal Representatives of Graham (Deceased) v Revenue and Customs Commissioners [2018] UKFTT 306 (TC)* provides a rare example of where the standard was actually reached to qualify for BR. In that case "exceptional" level of hotel-like additional services were provided by a business that had previously operated as a bed-and-breakfast and a small converted hotel, and even then was only found by a fine margin to fall on the non-investment side of the trading test overall. It would appear to be very difficult for any holiday lets where guests have a "property to call their own" to come within the scope of BR.

In the First Tier Tribunal case of *Re Vigne (Deceased) (2017) UKFTT 0632* business property relief was allowed for a livery stable business. This discussion was upheld on appeal to the Upper Tax Tribunal *(Revenue and Customs Commissioners v Vigne's Personal Representatives [2018] UKUT 357 (TCC))*.

8.6 **"Excepted assets" – s.112**

In determining the value of any "relevant business property" for BR some assets ("excepted assets") are left out of account, thus reducing the relief. This is intended to prevent business owners putting or leaving personal assets in their businesses to shelter them from IHT. To avoid being treated as an excepted asset an asset must satisfy one of the following two tests:

8.6.1 The asset must be used wholly or mainly *for the purposes of the business* concerned throughout the whole of the preceding two years (or for such lesser period as the transferor, or company, in fact owned the asset), or

8.6.2 At the time of transfer the asset must be required for *future use* for the purposes of the business. In this context, the amount of cash held by a business often attracts scrutiny by HMRC. In *Barclays Bank Trust Co Ltd v IRC* [1998] STC (SCD) 125 the deceased held 50% of the shares in a bathroom fitting business, and the company held more than £450,000 cash at the date of his death in 1990. It was held that only £150,000 was needed at the time for future use by the business. The fact that the company later, in 1997, spent £335,000 on importing goods from China was not an indication that the cash was 'required' for future use of the business at the date of the deceased's death.

8.7 **BR on gifts**

BR can be claimed on a lifetime gift of a business as on a transfer on death. Before *Nelson Dance Family Settlement Trustees v HMRC* [2008] STC (SCD) 792, there was doubt that a gift of assets used in a business would qualify for BR as a "business or an interest in business" unless the gift included the whole business or the transferor's interest in a business. In *Nelson Dance*, farmland was transferred to a discretionary settlement. The land (359 acres and 2 cottages out of an estate of 1,735 acres) qualified for agricultural property relief, but, as it also had development value, the trustees claimed BR on the excess value of the land over its agricultural value. HMRC denied relief on the basis that what had been transferred were mere assets, not the business itself. However, the trustees' claim was upheld by the Special Commissioners and then, on appeal, by the High Court. The transferor had made a transfer resulting in loss to his estate, and that loss of value was attributable to land that was, immediately before the transfer, part of a business, no matter that the land was not a business in the hands of the trustees.

9 AGRICULTURAL PROPERTY RELIEF

To the extent that a transfer of value (whether a lifetime transfer or on death) includes *agricultural property*, the agricultural value transferred is reduced by a percentage. The percentage reduction, currently 100% or 50%, is known as agricultural property relief ("APR").

Where APR and BR arise in respect of the same property, APR must be applied before BR. However, there may also be relief under BR for the non-agricultural value. Hence, in the case of a farmer who owns land and farms it as a business the whole of the value of the farm should be relieved by a combination of APR and BR.

9.1 Agricultural property

Agricultural property means agricultural land or pasture. Buildings used in connection with intensive rearing of livestock or fish if occupied with agricultural land or pasture and the occupation of the buildings ancillary to it, count as agricultural property.

Woodlands qualify if occupied with agricultural land or pasture and the occupation is ancillary to the occupation of that land or pasture. This is intended to include copses, shelter belts, amenity woodland and coverts, not substantial tracts of land managed as commercial forestry.

Cottages, farm buildings and farmhouses (together with the land occupied with them) are agricultural property provided they are of a *character appropriate* to the agricultural land or pasture.

9.2 Defining a farmhouse

An analysis of whether a farmhouse is agricultural property involves answering two questions: First, whether the dwelling in question is a farmhouse for the purposes of the relief, and secondly whether it is of a character appropriate. In *Arnander (executors of McKenna deceased) v Revenue & Customs Commissioners* [2006] STC (SCD) 800) it was held that the house in question was not a farmhouse. This was a substantial residence occupied by the deceased with 6 acres of gardens and domestic outbuildings, together with 187 acres of land, about 100 of which was farmland. In the last years of his life, Mr McKenna had delegated the contracting operations to a land agent, who had become responsible for the management of the land, the farming activities, the invoicing of the contractors and all discussions with the contractors. The day-to-day management and all acts of farm husbandry over the land had been solely the responsibility of the contractors, managed by the agent. The engagement of an agent to manage the land meant that the use of the house for farming matters had very much reduced to the extent that it could no longer be called a farmhouse at all. It was not therefore necessary to go on to the next stage and consider whether the house had been of a character appropriate to the agricultural land.

9.3 **The *character appropriate* test**

The current practice regarding the application of the character appropriate test to farmhouses has evolved as a result of a number of decided cases including *Higginson executors v IRC* [2002] STC (SCD) 483 and *Lloyds TSB (personal representative of Antrobus deceased) v IRC* [2002] STC (SCD) 468.

9.3.1 Is the farmhouse appropriate when judged by ordinary ideas of what is appropriate in size, layout, content, and style and quality of construction in relation to the associated land and buildings?

9.3.2 Is the farmhouse proportionate in size and nature to the requirements of the agricultural activities conducted on the agricultural land?

9.3.3 Would a reasonable and informed person regard the property simply as a house with land or as a farmhouse?

9.3.4 Applying the "elephant test" would you recognise this as a farmhouse if you saw it?

9.3.5 How long has the farmhouse and agricultural property been associated and is there is a history of agricultural production?

9.3.6 Considering the relationship between the value of the house and the profitability of the land, would the house attract demand from a commercial farmer who has to earn a living from the land, or is its value significantly out of proportion to the profitability of the land?

9.3.7 Considering all other relevant factors, including whether any land is let out and on what terms, is the scale of the agricultural operations in context?

9.3.8 There must be some connection or nexus between "such cottages, farm buildings and farmhouses, together with the land occupied with them" and the property to which they relate must be of a character appropriate. In *Rosser v IRC [2003] STC (SCD) 311* that nexus was held to be derived from common ownership rather than common occupation. The more recent case of *Hanson v HMRC* (2012) UKFTT 95 has extended the scope from which the next can be derived to include common occupation.

It should be noted that HMRC have regard to the financial viability of the agricultural unit concerned when applying the character appropriate test in spite of the fact that APR is not otherwise applied by reference to whether the farming activities are profitable; there is no equivalent to s.103(3) in relation to BR. What is the position if as result of old age and other circumstances the farming activities have had to be scaled back? This was considered in *Arthur Frederick Golding, Julia Anne Middleton (executors of the Will of Dennis Golding deceased) v The Commissioners* [2011] UKFTT 351 (TC). The case concerned a farm of just 16 acres purchased in 1940. At the height of activity the deceased had had some 600 free range chickens, 7 – 10 cattle; harvested fruit from fruit trees and grew vegetables. The farm produced milk and grew wheat, barley and oats for sale. As from the 1980s when the deceased's daughter moved out of the farmhouse and his wife died, the activities on the farm had steadily reduced until at the end of his life they amounted to just the keeping of hens and selling of eggs from the farm gate. The vegetables grown on the farm were principally for the deceased's own consumption. It was held, however, that in a very limited way the deceased had still been working on the farm when he died. The level of activity was no less than could be expected of someone of his age (over 80). The farmhouse was in a run-down state and partly used for storage of produce. The average annual taxable profit was about £1,500. This represented no more than 20% of the deceased's total income and the Court was satisfied that the farm income alone would not

have been sufficient for the deceased to live off. However, the lack of a substantial profit was not detrimental to a decision that the farmhouse was character appropriate.

9.4 **Rates of relief**

100% relief applies in the following 5 cases and in all other cases at 50%:

9.4.1 Vacant possession – the transferor has vacant possession of the agricultural property, e.g. in-hand land.

9.4.2 Short-term loss of vacant possession – the transferor has the right to obtain vacant possession within 24 months (the 12 month period specified s.116(2)(a) is extended to 24 months by extra-statutory concession F17 (ESC F17), e.g. a farm business tenancy terminable with less than 24 months' notice.

9.4.3 Near vacant possession value – where the transferor's interest in the property transferred does not carry the right to vacant possession but is valued at or near vacant possession value, e.g. the land is let to a company controlled by the transferor (ESC F17).

9.4.4 Double discount – where the pre-1981 full-time working farmer relief provisions would have applied had they not been abolished and the transitional provisions are satisfied, e.g. land continuously let to a partnership or a company since before 10 March 1981 which the transferor has previously farmed in some capacity.

9.4.5 Land let subject to a tenancy beginning on or after 1 September 1995 – land subject to a tenancy beginning on or after 1 September 1995 qualifies for 100% relief whether or not the tenancy concerned is a farm business tenancy. It includes cases where land is let under a tenancy originally granted before 1 September 1995 but where there has been a subsequent valid retirement notice for a succession, or the tenant has died after that date and the tenancy has become vested or obtained by another person as a consequence. Note that Agricultural Tenancies Act 1995 s.4(1)(g) permits a new tenancy to be granted from 19 October 2006 to an existing Agricultural Holdings Act 1986 tenant over the same (or substantially the same) land and allows the tenant to enjoy the same security of tenure as before even though the new tenancy is expressly granted. 100% relief is available in respect of the underlying land in such circumstances.

9.5 **Occupation and ownership**

For APR to apply the transferor must have:

9.5.1 occupied the property for the purposes of agriculture throughout the 2 years before the transfer; or

9.5.2 owned the property throughout the last 7 years during which it must have been occupied for the purposes of agriculture either by the transferor or somebody else (s.117).

9.6 **Replacement property**

If the property transferred has replaced other agricultural property then the two conditions will be satisfied provided that:

9.6.1 overall the transferor had occupied the properties for the purposes of agriculture for at least 2 out of the last 5 years; or

9.6.2 the transferor had owned the properties (and somebody had occupied them for agriculture) for at least 7 out of the last 10 years (s.118).

If the property transferred was acquired on the death of the transferor's spouse or civil partner and the period of ownership or occupation of the first spouse/civil partner can count towards the 7 years or the 2 years required (s.120).

9.7 **Occupation**

A sole trader is clearly in occupation of an in-hand farm. Where a partnership is involved, each of the partners is in occupation.

If a company controlled by the owner occupies the farm, the transferor will be treated as occupying it (s.119).

Arrangements such as share-farming agreements and typical grazing agreements will usually involve occupation by both parties.

A dwelling occupied by a farm worker is deemed to be occupied by the employer.

One problem area is the temporary absence of the farmer from the farmhouse. If the farmhouse is maintained for his future occupation, and no other person is given a right to occupy it in the meantime, then it may be possible to argue that the farmer is still in occupation for the purposes of agriculture even though he may never return to the property because of death. The circumstances may indicate an intention to return to the property for the purposes of continuing the farming business. In the case of *Harrold v IRC* [1996] STC (SCD) 195 during the critical 2 year period prior to a transfer the farmhouse had been unoccupied and unfurnished and only visited to carry out minor repairs and latterly had been subject to major renovations with a view to the future occupation by the transferor's son. It was held that the property was not occupied for the purposes of agriculture.

In *Atkinson and Smith* (*executors of the Will* of *William Atkinson deceased) v The Revenue & Customs Commissioners* (2012) STC 289 Mr Atkinson had owned and occupied a bungalow until ill-health forced him first to a hospital and then to a care home for the last 4 years of his life. The farm, including the bungalow, was let on an agricultural tenancy to a family farming partnership, of which Mr Atkinson remained a partner until his death. During Mr Atkinson's illness the bungalow was unoccupied although remained furnished and contained his belongings. The executors contended that the partnership, not the deceased, was the occupier of the bungalow and so the fact that Mr Atkinson had moved into a care home was not relevant. They succeeded at the First-tier Tax Tribunal but the decision by the Upper Tribunal was reversed on appeal. It was held that a significant change took place when Mr Atkinson moved into the care home and the property ceased to be used for the purposes of agriculture. It might have been different if the partnership made some other use of the property during the four year period concerned, such as using it as an office or if there was any expectation that Mr Atkinson might move back into the property, but neither was the case.

9.8 **For the purposes of agriculture**

Having established that there is occupation, one needs to look at whether the occupation was for the purposes of agriculture. In practice, any agricultural property that is occupied for the following purposes will satisfy the occupation test:

- cultivation to produce food for human or animal consumption;
- by livestock to produce food (themselves or through their products, such as milk);

- by working farm animals;
- by sheep for wool;
- for set-aside or fallow;
- as grassland for grazing by agricultural animals; and
- for the purposes of breeding but in the case of horses only on a stud farm.

Farm cottages will be occupied for the purposes of agriculture if occupied by an employee working on the farm. HMRC regard the condition as satisfied if the cottage is occupied by a retired farm worker or his or her surviving spouse, if the occupation is either:

- protected under Rent (Agricultural) Act 1976 or the Housing Act 1988, or
- under a lease granted as part of the workers agricultural employment contract which has a similar effect to that of a protected tenancy or licence.

Land and buildings not actively used in farming but dedicated under certain wildlife habitat schemes qualify as agricultural property.

Land on which short rotation coppice is cultivated also qualifies as agricultural property as do buildings (and land occupied with them) used in connection with short rotation coppicing provided they are of a character appropriate.

9.9 **Agricultural value**

Agricultural value is taken as the *value of the property if it was subject to a perpetual covenant prohibiting its use other than as agricultural property* (s115(3)).

HMRC regard the perpetual covenant within s115(3), when applied to farmhouses, as equivalent to the agricultural occupancy condition ("AOC") in a planning permission. The standard AOC normally limits the occupation of a dwelling to a person solely or mainly working in the locality in agriculture or in forestry, or a widow or widower of such a person, and to any resident dependants. Typically an AOC would reduce the value of a farmhouse by about 1/3rd from what its value would be without an AOC. The question whether AOC is a true equivalent to the covenant in s115(3) was dealt with in the 2nd Appeal of the *Antrobus* case (DET/47/2004), before the Lands Tribunal, where the taxpayer had argued that the house in question could be occupied by anyone who farmed the surrounding land from the house and this would make the house a farmhouse. The occupier of the house need not be mainly devoted to running the farm, and hence could include someone who would not meet the conditions attaching to a normal AOC. On this basis, the market for the farmhouse would include a lifestyle buyer, i.e. someone whose main source of income maybe from other, non-farming activities, but who wanted to enjoy the lifestyle and advantages associated with living on a farm. The Lands Tribunal also took a narrower view of what made a house a farmhouse and held that a farmhouse is the house of the person who lives in it in order to farm the land comprised in the farm and who farms the land on a day-to-day basis, and therefore it followed that a lifestyle buyer of the property would be unlikely to occupy it as a farmhouse. The narrow construction of what could be a farmhouse forced the Tribunal to dismiss the effect of lifestyle buyers in the market. On the basis of the comparables presented in the case the Tribunal concluded that the agricultural value of the property was 70% of its open market value. It was stated, however, that if lifestyle buyers could be admitted as possible purchasers under the hypothesised covenant, then the agricultural value would be 85% of the open market value.

Note that, unlike other agricultural property, qualifying cottages attract APR on the open market value. Relief is not restricted to agricultural value.

10 OTHER RELIEFS

10.1 Woodlands relief - s.125(3)

On a person's death an election can be made to pay IHT just on the value of the land and to defer IHT in respect of any trees or underwood on the land. The tax becomes chargeable when the trees are later sold.

If the woodland qualifies for APR relief then woodland relief may not apply and APR should be claimed instead. Note also interaction with BR.

10.2 Heritage relief – s.30

10.2.1 No IHT is payable in respect of land, buildings and objects of the requisite heritage quality.

10.2.2 Relief is given on a conditional basis in return for the provision of undertakings relating to the preservation of the property and for securing reasonable public access to it.

10.2.3 Upon the sale or upon any breach of an undertaking, the conditional exemption is withdrawn and a charge to tax arises.

CAPITAL GAINS TAX

BACKGROUND TO CAPITAL GAINS TAX

1 CHARGE TO CGT

A person is chargeable to CGT in respect of chargeable gains accruing to him in a tax year during any part of which he is resident in the UK (Taxation of Chargeable Gains Act 1992, s.1(1).

CGT is charged on chargeable gains made by individuals, personal representatives and trustees on the disposal of assets.

1.1 Disposal

Disposal includes the sale, but also capital sums received on loss or destruction of an asset, e.g. insurance or other forms of compensation.

1.2 Assets

Assets includes all forms of property, wherever situated, including incorporeal property (options, debts etc.) (s.21(1)).

1.3 Gifts and other deemed market value disposals

Disposals by way of gift or disposals made otherwise than at arms' length are treated as sales at market value as at the date of the gift or the bargain. The market value is also substituted as the acquisition cost for the donee/purchaser.

Certain transactions are deemed to be not at arms' length, irrespective of the actual price paid and the other terms of the bargain, including disposals of assets to connected persons. Persons may be

connected because of family relationships, e.g. relatives. A person is also connected with another person with whom he is in partnership.

1.4 Date of disposal

Where an asset is disposed of under contract, the date of the disposal is the date of the unconditional contract. If the contract is conditional, the date of satisfaction of the condition is the date of the disposal.

2 COMPUTATION OF THE GAIN

Once a disposal has happened and the consideration for the disposal, or the deemed consideration has been determined by the market value rule, the chargeable gain can be worked out as follows:

2.1 Deduct allowable expenditure

2.1.1 The historic cost of the asset (or, if value re-basing applies, the value of the asset at 31 March 1982 is substituted). This will include professional fees incurred in connection with the acquisition as well as stamp duty land tax.

2.1.2 Any capital expenditure on improvements to the asset is deducted provided these improvements are reflected in the state or nature of the asset at the time of its disposal.

2.1.3 The incidental costs of the disposal, e.g. professional fees and selling agent fees. Any costs incurred to obtain valuations for the purposes of CGT, where re-basing occurs or the market value rule applies, are also deductible.

2.2 Part disposals

Where part of the asset is disposed of and part retained, there is a special set of rules for calculating the gain based upon the principle of deducting from the sale proceeds the proportion of costs which the value of the part sold bears, at the time of the disposal, to the value of the whole asset.

2.3 Losses

The charge to CGT is on all chargeable gains accruing to the taxpayer in a tax year, less any allowable losses (s.2(2)). Losses are calculated in the same way as chargeable gains. The basic rule is that losses incurred in a tax year are set off against gains of the same tax year, and to the extent that they cannot be set off, are carried forward for set off against gains of subsequent years. With a few exceptions, losses cannot be set off against gains of previous tax years.

2.4 Annual allowance

As of 6 April 2024, the annual exemption for individuals is £3,000. The annual exemption for trustees is half that of individuals and therefore £1,500.

2.5 Rates of CGT

Gains of individuals (excluding residential property) are liable to CGT at 20% where any part of the individual's income is chargeable to the higher income tax rate or the dividend upper rate.

If an individual is chargeable to CGT on an amount of gains that exceeds the unused part of the individual's basic rate band, then the higher 20% rate applies to the excess. Otherwise the rate is 10%.

Gains on the sale of residential property that do not qualify for principal private residence relief are subject to CGT rates of 24% for higher income tax payers or 18% for basic rate tax payers.

Where Business Asset Disposal Relief applies the gains qualifying for that relief are taxed at 10%.

Any gains made by trustees or by personal representatives (excluding residential property) are liable to CGT at 20%.

3 BUSINESS ASSET DISPOSAL RELIEF (FORMERLY ENTREPRENEURS' RELIEF)

Business Asset Disposal Relief applies a 10% rate to gains arising on *qualifying business disposals*. Prior to 2020/21, the relief was called Entrepreneurs' Relief.

The relief is subject to a current lifetime limit of £1m (down from £10m for disposals prior to 11 March 2020).

A qualifying business disposal occurs where there has been one of any of the following 3 categories of disposal:

- a *material disposal* of business assets by an individual;
- an *associated disposal* by an individual; or
- a disposal of *settlement business assets* by trustees.

A business is defined as being a commercial trade, profession or vocation carried on for gain. Note that the relief is not applied to gains arising on non-business assets.

3.1 **Material disposal of business assets – s.169I**

The following are material disposals:

3.1.1 *Disposal of the whole or part of the business* that the individual has owned throughout the immediate preceding two years. It is not sufficient that the disposal consists simply of an asset, or a number of assets. Such assets must together amount to a business or part of a business. Whether they do so or not is a question of fact and degree depending upon all the surrounding circumstances of the particular case. If the nature and extent of the business concerned remains essentially unchanged after the sale, it cannot be said that part of the business has been sold. Where, for example, a farmer sells 5 acres out of 100, it will be difficult to argue that the nature and extent of the farming business has not essentially remained unchanged.

3.1.2 Where a business, which has ceased within the previous 3 years, had been owned by that individual throughout the two year period prior to cessation, a *disposal of one or more assets* previously in use for the purposes of the ceased business at the date of its cessation.

3.1.3 A disposal of shares or securities in a qualifying company. The conditions are that the company has to be both the individual's personal company and either a trading company or the holding company of a trading company. A personal company is one in which the individual has at least 5% of the ordinary share capital and by virtue of that holding is able to exercise at least 5% of the voting rights. In addition, the individual must either be entitled to at least 5% of the distributable profits available to equity holders and 5% of the assets available on a winding up, and/or be entitled to at least 5% of the proceeds of a disposal of the whole of the ordinary share capital of the company.

3.2 **Disposal associated with a material disposal – s.169K**

Where an individual sells his shares in a company or his interest in a partnership, he can also claim relief in respect of the sale of assets used by the company or partnership as the case may be.

For all disposals after 18 March 2015 there must have been either:

3.2.1 a material disposal of business assets consisting of at least a 5% interest in the assets of a partnership (or if their interest is less than 5%, they dispose of the whole of their interest and for a period of 3 years in the 8 years ending on the date of disposal, their interest was at least 5%) and at the date of disposal there are no arrangements under which the individual or a connected person is entitled to acquire or increase an interest in the partnership; or

3.2.2 a material disposal of business assets consisting of a disposal of shares and

3.2.2.a the shares disposed of constitute at least 5% of the company's share capital and carry at least 5% of the voting rights. In addition, the individual must either be entitled to at least 5% of the distributable profits available to equity holders and 5% of the assets available on a winding up, and/or be entitled to at least 5% of the proceeds of a disposal of the whole of the ordinary share capital of the company; and

3.2.2.b at the date of disposal there are no arrangements under which the individual making the disposal or a connected person is entitled to acquire shares or securities in the company or a within the same trading group; or

3.2.3 a material disposal of business assets consisting of at least a 5% of the value of securities in the company and at the date of disposal there are no arrangements under which the individual making the disposal or a connected person is entitled to acquire shares or securities in the company or a within the same trading group.

In addition:

3.2.4 the individual withdraws from participation in the partnership, company or trading group of companies and at the date of disposal there are no partnership purchase or share purchase arrangements; and

3.2.5 the asset has been so used for a period of 2 years immediately before the date of the material disposal or, if earlier, the date that the business ceased.

3.3 **Disposal of trust business assets – s.169J**

The relief is also extended to the disposal of settlement business assets (shares, securities or assets of a business) by trustees.

3.3.1 To qualify the assets must be held so that a beneficiary has a life interest and the beneficiary has to have been carrying on the business.

3.3.2 If the disposal is of shares or securities, the beneficiary must have owned at least a 5% shareholding in his own name and been an officer or employee of the company.

4 ROLL-OVER RELIEF (REPLACEMENT OF BUSINESS ASSETS) – SS.152-160

4.1 The relief

Roll-over relief is available where one business asset is sold in order to provide funds to purchase another asset for use in the business. The capital gain which would have been chargeable on the asset sold is deducted from the historic cost base of the new asset in the computation of the gain on that asset, when it in turn is sold. It therefore represents a deferral of the tax.

4.2 Time limit

The replacement assets must be acquired within one year before or three years after the disposal of the old assets.

4.3 The conditions for the relief -

4.3.1 a person carrying on a trade sells assets (the old assets) used, and used only, for the purposes of a trade throughout his period of ownership;

4.3.2 he uses the sale proceeds within the specified time period to buy other assets (the new assets), which are immediately taken into use, and used only, for the purposes of the trade; and

4.3.3 the old assets and the new assets are within certain specified classes of assets, including land and buildings and fixed plant and machinery.

5 HOLD-OVER RELIEFS

An asset which is gifted is treated as having been sold at its current market value as at the date of the gift. Hold-over relief allows the chargeable gain to be deferred until a subsequent disposal. There are two hold-over reliefs that apply respectively to gifts of business assets and lifetime gifts which are chargeable to IHT.

5.1 Gift of business assets – s.165

Business assets are:

5.1.1 assets used for the purposes of a trade, profession or vocation carried on by the donor or a company in which he has at least a 5% shareholding; or

5.1.2 shares or securities of a "trading company".

5.2 A trading company is

5.2.1 unlisted; or

5.2.2 listed and the donor has at least a 5% shareholding; and

5.2.3 in either case does not include *to a substantial extent* non-trading activities (e.g. letting part of the business premises). Note that this is different from the *wholly or mainly* test for BR. HMRC take "substantial" to mean more than 20%.

5.3 Agricultural property

Assets which qualify for IHT agricultural property relief also qualify as business assets for the purposes of hold-over relief irrespective of whether they are used for business purposes by the donor.

5.4 **Gifts chargeable to IHT – s.260**

Gains realised on the gift of an asset which is chargeable immediately to IHT or would be chargeable to IHT but for certain reliefs or exemptions. A common example would be the transfer of an asset to a trust, i.e. a lifetime chargeable transfer.

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