

BPR – Excepted Assets (Lecture P1354 – 11.55 minutes)

Background

Business property relief (or BPR) offers inheritance tax (IHT) relief of 100% or 50% on a transfer of value attributable to 'relevant business property'. For example, unquoted company shares potentially qualify for 100% BPR.

Not all unquoted company shares qualify for BPR. Certain company activities can make the shares ineligible for relief, such as dealing in stocks or shares, land or buildings, or making or holding investments (IHTA 1984, s 105(3)). These exclusions are subject to certain exceptions (in s 105(4), (4A)), including where the company's business consists wholly or mainly of being a holding company of a group of companies whose business doesn't consist of excluded activities.

Purpose and effect

There is an important restriction in BPR in respect of 'excepted assets'. This restriction in IHTA 1984, s 112, is essentially an anti-avoidance rule.

For example, without the excepted assets provision, a wealthy individual shareholder of an unquoted trading company might try to secure BPR on his private wealth by using the cash to subscribe for additional shares in the company. Those funds might then be parked in the company without being needed or used in any business being carried on by the company.

Effectively, the individual would be treating the company as their personal 'money box', on the basis that the funds are sheltered from IHT (assuming 100% BPR is available on the company's shares). Alternatively, the shareholder might be tempted to transfer (say) a vintage car into their company, hoping that the car will become sheltered from IHT.

If 'caught' by the excepted assets legislation, the value of the shares on which BPR is available would be subject to a potential restriction in respect of the non-business assets sitting in the company.

Is it 'excepted'?

The definition of 'excepted asset' that applies to most categories of relevant business property is contained in IHTA 1984, s 112(2). This legislation broadly states that an asset is an excepted asset if either of two alternative tests (essentially a 'past use' and 'future use' test) is met:

“(2) An asset is an excepted asset in relation to any relevant business property if it was neither—

- (a) used wholly or mainly for the purposes of the business concerned throughout the whole or the last two years of the relevant period defined in subsection (5) below, nor
- (b) required at the time of the transfer for future use for those purposes;”

There is a relaxation of the excepted asset rules in respect of group companies, but our focus is on the single unquoted trading company.

Confusingly, HMRC's guidance in the Inheritance Tax manual (at IHTM25341 and IHTM25351) indicates that for an asset not to be excepted, the asset in question must not be caught by either the 'past use' or 'future use' test. However, HMRC's view does not seem to be in accordance with the legislation itself, which indicates that the asset is not excepted provided it is not caught by at least one of the tests. In any event, it should be remembered that HMRC's manuals are not legally binding.

Excepted asset value

If 'caught' by the excepted assets legislation, the effect is broadly that a transfer of value for BPR purposes is restricted by the value attributable to the excepted assets. Only that part of a transfer of value which relates to relevant business property is reduced by BPR; the other part relating to the excepted asset is not reduced by BPR and is therefore chargeable to IHT in the normal way.

This could raise some interesting valuation issues, especially when valuing a minority shareholding.

Practical issues

One of the categories of assets potentially eligible for BPR is land or buildings, machinery or plant which, immediately before the transfer was used wholly or mainly for the purposes of a business carried on by a company of which the asset owner had control (IHTA 1984, s 105(1)(d)).

The excepted assets 'past use' test and 'future' use tests do not apply to such assets. However, for the asset not to be excepted, it must either have been used for business purposes throughout the immediately preceding two years or have replaced another eligible business asset where the periods of ownership combined were two out of the five immediately preceding years. This might apply if (say) an unincorporated business is transferred to a company on incorporation, and the asset remains held outside the company but continues to be used in the business.

There is a similar rule where the 'successive transfer' provision applies in IHTA 1984, s 109 (which provides an exception from the normal two-year asset holding requirement for BPR purposes where one of the transfers in question was made on death, and certain other conditions are met) (IHTA 1984, s 112(3)).

There is also a helpful relaxation in the excepted asset rules in respect of land and buildings (IHTA 1984, s 112(4)). It broadly applies where part is used exclusively for business purposes, but the whole of the land and buildings is not used wholly or mainly for business purposes. In those circumstances, the part used exclusively for business purposes and the rest of the property are treated as separate assets, and the value of the land and buildings as a whole is apportioned between the two parts.

It is important to watch out for assets used wholly or mainly for the personal benefit of the shareholder or a 'connected person'. For excepted asset purposes, such assets are deemed not to have been used wholly or mainly for the purposes of the business concerned during those periods of personal use (IHTA 1984, s 112(6)). This would prevent BPR on an asset such as a yacht held by the company which is commercially rented out to third party customers for part of the time to create the illusion that it is a business asset, when in fact for the majority of the time it is used by the shareholder and family members for private purposes. No BPR would be due on the value of the yacht in those circumstances.

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