

BPR and surplus cash in the company (Lecture P1258 – 12.34 minutes)

BPR and company shares

Business property relief (BPR) applies to various form of 'relevant business property' for inheritance tax (IHT) purposes, including shares in an unquoted company.

The shares are not relevant business property if the company wholly or mainly carries on certain excluded activities, i.e. dealing in securities, stocks or shares, land or buildings or making or holding investments (IHTA 1984, s 105(3); all references are to IHTA 1984).

These exclusions are subject to certain exceptions (in s 105(4), (4A)), including where the company's business consists wholly or mainly in being a holding company of a group of companies whose business does not consist of excluded activities.

Is it 'excepted'?

If BPR applies, the value of relevant business property on which BPR is available is subject to a restriction in respect of the value of excepted assets.

The legislation in s 112 ('Exclusion of value of excepted assets') provides that an asset is an 'excepted asset' unless it satisfies at least one of two alternative tests (in s 112(2)):

"(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..., nor

(b) required at the time of the transfer for future use for those purposes;"

'Past use' test

The 'relevant period' in s 112(2)(a) above is either the two years immediately preceding the transfer of value in question, or the whole period of ownership if less than two years.

Thus (for example) a trading company may use surplus cash to acquire assets wholly or mainly for business purposes (e.g. plant and machinery), even if the acquisition takes place shortly before a transfer of shares in the company (on which BPR is claimed).

'Future use' test

If a trading company has (say) a large credit balance on its bank account, how much (if any) of that cash balance is 'surplus'? The 'future use' test in IHTA 1984, s 112(2)(b) can cause difficulties in practice.

For example, in *Barclays Bank Trust Co Ltd v IRC* [1998] STC (SCD) 125, the deceased held 50% of the shares in a company carrying on an old established trade of selling bathroom and kitchen fittings. It had a strong cash position. At the time of the deceased's death, the company held over £450,000 in cash. The Inland Revenue (as it was then) accepted that £150,000 was needed by the company at that time but maintained that the remaining £300,000 was an excepted asset.

The Special Commissioner upheld the Revenue's view, rejecting the argument that the cash was required for the future purposes of the businesses. The appeal was dismissed.

HMRC's view: Or is it?

If an asset is not 'caught' by one (or both) of the 'past use' and 'future use' tests, it is not an excepted asset, and BPR is not restricted on that basis. However, at the time of writing, HMRC guidance in its Inheritance Tax manual states (at IHTM25341):

'In broad terms IHTA84/S112 relates only to the assets used in the business and it makes them excepted assets... (i.e. it excludes them from relief) unless

- they were used wholly or mainly for the purposes of the business throughout the whole or the last two years of the relevant period, and
- they are required for future use for those purposes.'

The key word here is 'and'. It means that an asset would need to escape being caught by both the 'past use' and 'future use' tests to prevent being categorised as an excepted asset. The HMRC guidance does not appear to accord with the legislation. This point has been brought to HMRC's attention, but the guidance has not yet been changed.

Is it 'surplus'?

In practice, whether cash is 'surplus' will depend on the particular circumstances in each case. Factors to consider include the following:

1. Every trading company needs working capital. For example, in the *Barclays Bank Trust* case, the undisputed amount of cash needed by the company represented roughly 25% of its turnover.
2. Seasonal businesses will often hold substantial cash at certain times of the year.
3. Business owners may retain a higher proportion of funds during difficult trading conditions (not least due to the reluctance of banks to provide working capital in some cases).
4. To the extent that cash is surplus, the business may apply those funds in (for example) paying trade creditors or discharging other liabilities of the business.
5. The surplus cash could be used towards separate investment business activities. However, extreme care should be taken to ensure that the investment business activities do not predominate; otherwise, BPR may be lost entirely (IHTA 1984, s 105(3)).
6. If cash has been earmarked for future business use, clear evidence should be maintained of its intended use.

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