

MINIMISING CAPITAL TAXATION EXPOSURE ON PROPERTY ACTIVITIES

Introduction

The UK gives a number of exemptions for business and agricultural property from Inheritance Tax ("IHT") but the conditions are tightly drawn and there have recently been a number of keenly contested Court cases on certain aspects. The difference between a total exemption from IHT and a 40% IHT charge can be significant but often may be eliminated through advance planning. For Capital Gains Tax ("CGT") a 10% rate may apply in certain circumstances on a disposal of land or buildings but again the conditions are complex and need careful consideration. In the absence of planning, a 28% charge may arise. In the past few years we have successfully restructured many clients' property activities and achieved significant long term savings for the benefit of the family and other interests concerned. Some examples of typical cases are set out below:

1. Alison lets out 100 acres of farmland worth £1m to a tenant through a tenancy agreement entered into in the 1980s. She has a house worth £325,000 and no other assets and in the absence of planning £200,000 of IHT would be payable but with careful planning this could be reduced to nil through a new tenancy agreement.
2. Gavin owns 100 acres of farmland which has been zoned for development and hence is worth £100,000 per acre. The land is let to an agricultural tenant and in the absence of planning, up to £2.8m of CGT would be due on the disposal. On Gavin's death, only the agricultural value would be exempt and hence an IHT liability of over £3m would arise at that time. With good advice, the CGT could be reduced by £1.8m and the value of the land might be wholly exempt from IHT with no liability therefore arising.
3. Tom is in partnership with his son farming land held by Tom outside the business. If Tom dies, only 50% of the farmland value would be exempt from IHT whereas if it is introduced into the partnership (even with Tom retaining capital rights) an outright exemption may apply.
4. Paul owns an investment company worth £4m and farmland worth £3m. He has borrowing secured on the farmland of £2m. Presently the IHT on his death would be £1.6m but this could be reduced to £800,000 if the security for the borrowing is transferred to the investment company shares.
5. Brian owns a farming business and has done for many years. He diversifies through letting all his barns out to unconnected third parties and renting out some cottages. He does not realise that the value of the barns and cottages is now subject to 40% IHT on his death and might have planned matters to avoid this by, for example, transferring the barns and cottages into Trust tax free, prior to their change of use.
6. Edward has run a farming business at Greenacres for many years and owns ten let cottages on the farm. Although the capital value of the cottages is quite high, the net income is modest and very little of his employees' time is spent on this activity. Edward had successfully planned matters such that the value of the cottages (although prima facie an investment activity) is exempt from IHT on the basis that the overall Greenacres business is not that of holding or making investments.
7. Fred has run a farm for many years and has brought his wife Sarah into the partnership but continues to hold the farmhouse in his own name. As a result, full IHT may be due on the farmhouse which could be avoided to a large extent through bringing it into the partnership and keeping evidence of business activity.

Conclusions

We trust these examples demonstrate the potential for significantly reduced capital tax liabilities for clients who undertake advance planning.

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