

The value of trading status for taxation

The distinction between trading activity and non-trading activity is important in taxation terms because a trading business will attract significant tax reliefs, whereas a non-trading business will not

Capital gains tax

This was always a concern with taper relief from capital gains tax ("CGT"), which was abolished with effect from April 6, 2008, because the difference between "trading" and "non-trading" meant a difference between paying CGT at a rate of up to 40% and paying at a rate of 10%. The importance of trading status continues to apply for the less generous "entrepreneurs' relief", which replaced taper relief from April 6, 2008, and which can reduce the rate of CGT to 10% on the first £1 million of gains.

Both taper relief and entrepreneurs' relief allow some degree of non-trading activity, as long as it is not "significant", which is interpreted by HM Revenue & Customs as meaning more than 20% of the total activity (by reference to a number of factors including turnover, capital employed and

(for example a partnership or personal business) is business property relief. Business property relief is currently applied at a rate of 100% on qualifying shares and businesses, so that the value of such shares or interest in a business will not suffer inheritance tax on the death of the owner.

"Trading" is a crucial condition for the relief to apply, but it is often not satisfied. What may appear to be a trading company or business may not be such for tax purposes. Like capital gains tax, there is a level of non-trading activity which is permitted, but for inheritance tax purposes the proportion of a company's or trader's non-trading activity can extend up to 50% of the total activity.

In the case of shares in a trading company, it may be necessary to distinguish a business activity (whether a trading or non-trading activity)

'The main relief from inheritance tax for owners of shares in a trading company or an interest in a trading business (for example a partnership or personal business) is business property relief'

management time incurred). Therefore, the shares in a company which carries on a trade but which lets out premises which are surplus to its trading requirements, may not be eligible for entrepreneurs' relief if the value of those premises or the rent from those premises is greater than 20% of the value of the total assets owned by the company or the total income received by the company respectively.

Entrepreneurs' relief requires a number of other conditions to be met, in addition to the unquoted trading requirement, but this article focuses only on the issue of trading.

Inheritance tax

The main relief from inheritance tax for owners of shares in an unquoted trading company or an interest in a trading business

from an activity which does not amount to a business at all. If an asset which is held within the company is not used in a business activity (whether trading or not), business property relief can be restricted, even if that company is categorised as a mainly trading company. Conversely, a trading company can hold non-trading assets if they amount to a business, without jeopardising the business property relief on the shares in the company.

A fine line

A recent case earlier this year highlighted the fine dividing line between trading and non-trading activity.

In that case, a company which developed land and property (a trade) acquired commercial units for which it received rent (an invest-



David Bird, partner

ment activity). On the death of a shareholder, HM Revenue & Customs sought to deny business property relief from inheritance tax on his shares, on the basis that the rental income was greater than the property development profit, so that, arguably, the company was carrying on a business which comprised mainly an investment business.

On appeal by the shareholder's executors, the Special

receiving rent or simply selling them at a profit.

This was therefore a victory for the taxpayer (or his estate), but it could have been decided either way and may be appealed by HM Revenue.

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Commissioners of HM Revenue decided that the company's main activity remained that of a property development trade, because the intention of the company (through its directors) was always to buy properties with a long term development potential which they could develop and sell and that, although the rental income was relatively large, the company's intention was not to hold properties with the objective of

that a company was carrying on a trade, it is advisable to make careful minutes of directors' meetings, to record the intention of the directors in acquiring assets which may not directly relate to the company's normal trade.

*Details: David Bird
023-8048-2103
david.bird@parissmith.co.uk*

 Paris Smith