

Update: personal tax and trusts

David Bird considers recent cases on business property tax relief, shares as consideration for a loan and residence issues, and the changes to HMRC interest rates

SOME OF THE more interesting recent developments relating to taxation on owners of businesses and private companies are about changes in business activity, the definition of business property, and consideration for shares in a business.

Change in business activity

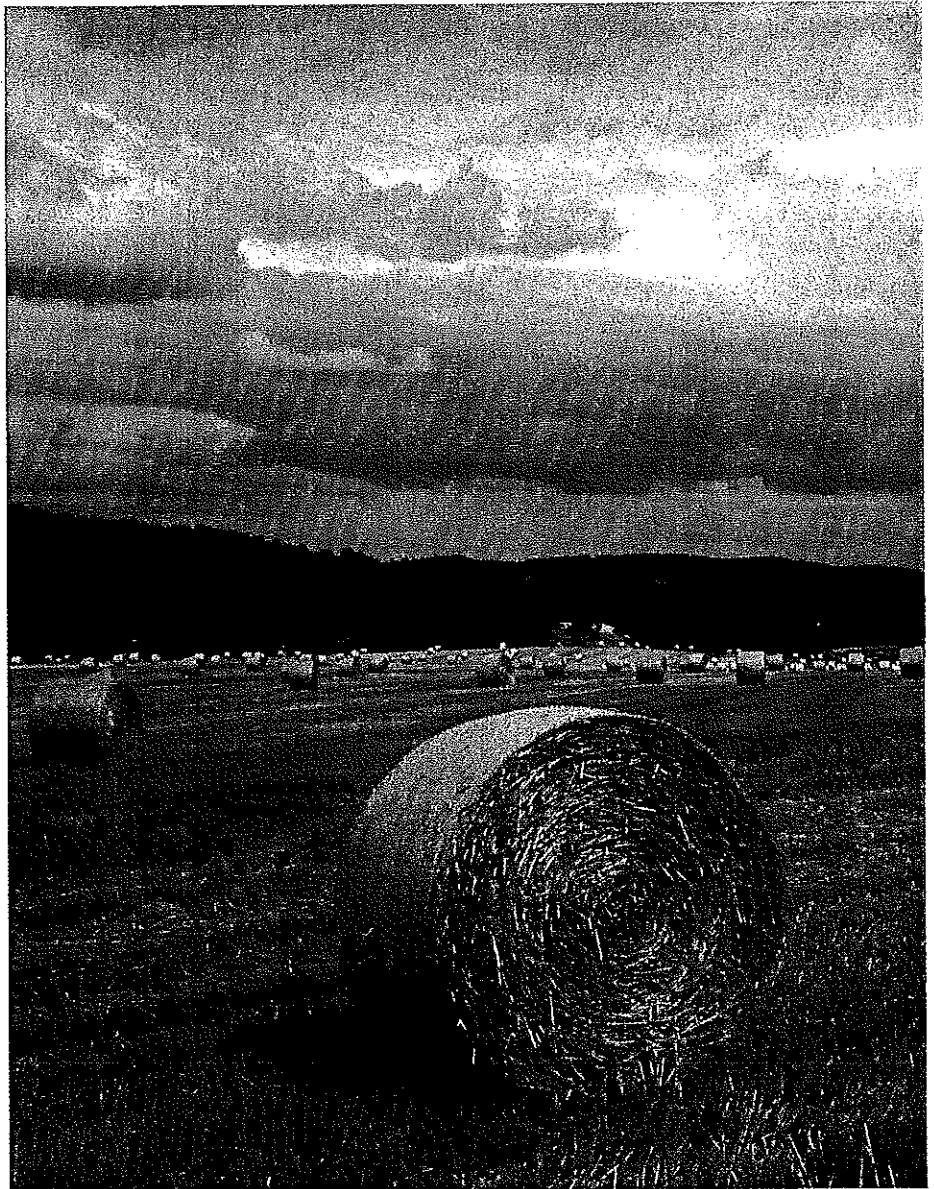
Executors of *D WC Piercy v Revenue & Customs Commissioners* [2008] (SpC 687) involved the eligibility for business property relief (BPR) of shares in a company which had held property for the purposes of a property development business, but which had changed the way in which it carried out its business. HMRC claimed that the change in activity had the effect of changing the company from one which was trading to one which carried on an activity that amounted to the holding of investments.

The company had developed and sold residential flats during the 1950s and 1960s, but in the 1970s it decided to move into the commercial property market. However the company acquired some commercial units which it was not able to develop because of financial issues and planning problems, and it consequently let those units on different leases during the 1990s. HMRC sought to deny BPR on the basis that the company had appropriated its trading stock to investment property because of the length of time for which it held the properties without developing them and the fact that the company had received rent, which was disproportionate to the profits from development.

As in previous cases relating to the availability of inheritance tax and capital gains tax reliefs, the intention of the property owner was a crucial factor. The property had initially been acquired as trading stock by a company and, despite letting the property, the company had never lost its intention to develop the land. Therefore the Commissioner found that BPR should apply to the shares held by the deceased.

Definition of business property

The case of *Revenue & Customs Commissioners*



BPR is available for agricultural land transferred as part of a business

v Trustees of the Nelson Dance Family Settlement [2009] EWHC 71 (Ch) is worth a mention because the decision of the court was contrary to a widely held understanding (as set out in textbooks) of how the BPR rules apply to business assets which do not themselves comprise a business.

The case concerned a farmer who carried on a farming business as a sole trader. The

assets employed in the business included 1,735 acres of agricultural land, agricultural buildings and two cottages. The farmer transferred the beneficial interest in two plots of land and the two cottages to a discretionary settlement.

The assets transferred did not in themselves comprise a business and so did not fall within the definition of business property

within s.105(1)(a) of the Inheritance Tax Act 1984 ('IHTA'). However, the main relieving provision in s.104(1) IHTA does not require that. Section 104(1) provides that the value transferred by a transfer of value is reduced by BPR where the value transferred is attributable to the value of any relevant business property (for example a business).

Mr Justice Sales decided that BPR was available because the reduction in the donor's estate – the transfer of value – was attributable to the value of the business. There is no requirement for BPR purposes that the asset transferred should be a business owned by the transferee after the transfer.

No evidence of consideration

In *Bird & Another v Revenue & Customs Commissioners* [2008] SpC 720, a husband and wife were the two equal shareholders in the company and were the only two directors. The husband, in his capacity as executor of his late father's estate, made a loan of £7,000 to the company from the estate. The residuary beneficiaries of the estate were the husband's children, who were all minors, contingently on reaching age 18. A further loan of about £54,000 was made to the company – also while the children were under the age of 18 – and was described as a loan from the children.

Shares were issued to the children for a subscription price of £1 per share, but the loan from the children to the company remained outstanding for another two years. There was no evidence that the children had provided fresh consideration.

HMRC assessed the dividends that were paid to the children as income of the parents under s.660 of the Income and Corporation Taxes Act 1988 ('ICTA 1988'). On appeal by the taxpayers, the commissioner decided that the assessment should stand, because the issue of shares was an "arrangement" that fell within s.660. The commissioner was not satisfied that the shares were issued in consideration for money provided by the children, so that the necessary element of bounty was present for s.660 to apply.

This case is a reminder of the necessary requirements for the settlements legislation to apply (now in Part 5, Chapter 5, of the Income Tax (Trading and Other Income) Act 2005), as was clarified in the Court of Appeal case of *Jones v Garnett* [2005] EWCA Civ 1553.

Changes to statutory legacy

The Family Provision (Intestate Succession) Order (2009/135) took effect from 1 February 2009 to change the statutory legacy payable

to a surviving spouse.

The Ministry of Justice estimates that, prior to 1 February, the lower level of the statutory legacy prevented the surviving spouse from recovering the whole estate in 9,000 estates each year, and in 3,600 estates the surviving spouse risked losing the family home. The figures for the upper level of statutory legacy were 1,600 and 640 respectively.

On 1 February, the statutory legacy for a surviving spouse where there are also surviving children increased from £125,000 to £250,000.

The statutory legacy in favour of the surviving spouse where there are no children has increased from £200,000 to £450,000.

"A person ceasing to be a UK resident needs to show a change in his habits and lifestyle"

Right to receive residue

In *Raymond Saul v Holden* [2008] EWHC 2731 Ch, the sole residuary legatee and executor (L) of an estate was declared bankrupt after the death of the testator. L was later discharged from bankruptcy, but he died before the end of the administration period. The solicitors who had acted for L – in his capacity as executor, but not in his personal capacity – advised him that L's trustee in bankruptcy was not entitled to receive the residue of the estate or any part of it.

The solicitors argued that the right to receive the residue of the estate needed to be differentiated from the right to the due administration of the estate and that the right to receive residue only existed at the end of the administration period. The solicitors therefore claimed that residue should be paid to L, because the administration period ceased after his discharge.

It was held that a residuary legatee's entitlement to have residue transferred to him arises at the date of death, not at the end of the administration period. The right to receive residue and the right to the due administration of the estate are part of a single chose in action and cannot be separated. As a result, when the residuary legatee was declared bankrupt, the 'chose in action' vested in its entirety in the trustee in bankruptcy.

There was an additional issue in this case, which related to the fact that the solicitors

were acting on behalf of the executor in resisting payment to the trustee in bankruptcy and were not at any time acting for the residuary legatee personally. The executor for the deceased residuary legatee was in favour of payment being made to the trustee in bankruptcy and did not support the solicitors' stance in refusing payment, which the executor considered to have been a waste of time and costs. The executor of the testator's estate should have taken a neutral stance and should have left the trustee in bankruptcy and residuary legatee to resolve the matter between them, but instead took an active role in pursuing the matter against the trustee in bankruptcy and therefore costs were awarded against the firm of solicitors.

Ceasing to be a UK resident

In *Revenue & Customs Commissioners v Lyle Dicker Grace* [2008] EWCH 2708 Ch, HMRC won their appeal against a special commissioner's decision that a long haul pilot who purchased a house in South Africa and spent most of his time there, despite retaining a house in the UK, was neither resident nor ordinarily resident in the UK. The special commissioner based her decision on the fact that the pilot only visited the UK because of his work and that he only spent time in the UK for a temporary purpose.

Section 336 of ICTA 1988 (as then applied) provided that where a person is in the UK for some temporary purpose, he shall not be treated as UK resident if he spends less than six months in the UK in a year of assessment. The court held that the pilot was not in the UK for a temporary purpose. The periods of residence in South Africa were periods of occasional residence.

This case highlights how difficult it can be in many cases for a person who is UK resident to cease to be UK resident, because he will need to show a change in his habits and lifestyle on leaving the UK, as set out in *IRC v Lysaght* [1928] AC 234.

HMRC interest rates

HMRC have announced changes to interest rates on taxes which take effect from 27 January 2009. These include a reduction in the rate of interest charged on late payments of capital gains tax from 4.5 per cent to 3 per cent. For overpayments, the rate of interest is reduced from 0.75 per cent to 0 per cent.

In the case of inheritance tax, the rate of interest for late payments or repayments is reduced from 2 per cent to 1 per cent.

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