

# THE BALFOUR CASE - LANDED ESTATES AND BUSINESS PROPERTY RELIEF

The Tax Tribunal's recent decision in *Brander (Personal Representative of the late 4th Earl of Balfour) v HMRC* (TC 69) has provided valuable guidance on the availability of inheritance tax business property relief (BPR) for traditional landed estates, confirming that a significant amount of letting income will not necessarily jeopardise a claim provided that 'the preponderance of activity and effort' in the management of the estate in question lies in trading activities.

## THE FACTS OF THE CASE

The 4th Earl of Balfour became the liferenter (the Scottish term for a life tenant) of the Whittingehame Estate on the death of his father in 1968. The estate extended to some 1,907 acres, including two in-hand farms covering 269 acres, three let farms comprising about 371 acres, 26 let houses and cottages which were mainly let on short assured tenancies, two sets of business premises, policy parks let on a seasonal basis and woodlands and forestry. There were also valuable sporting rights.

For a number of years prior to 2002, Lord Balfour operated the in-hand farming business, known as the Whittingehame Farming Company, either as a sole trader or in partnership with another person. The operations of this business on the one hand and the trustees' business on the other, which mainly consisted of the lettings on the estate, were separately registered for VAT purposes and also had separate accounts and invoicing arrangements. In November 2002, the trustees transferred the estate to Lord Balfour outright following a declaration by the House of Lords under the Entail Amendment (Scotland) Act 1848. In February 2003, Lord Balfour entered into partnership with his nephew and heir Michael Brander (with the effective date of commencement backdated to November 2002), and contributed and credited the whole of the estate to his own capital account.

The other capital of the partnership was contributed equally by Lord Balfour and Mr Brander (following a gift of one-half by the former to the latter). Lord Balfour died in June 2003.

In 2008, HMRC issued a notice listing a number of alternative reasons why the estate did not qualify for BPR, including that because Lord Balfour had entered into the partnership less than two years before his death the ownership test had not been satisfied (by virtue of sections 106 and 107 Inheritance Act 1984, property is not 'relevant business property' unless either it has been owned by the transferor throughout the two years immediately preceding the transfer or it replaces other relevant business property). The other main issue was whether the estate had been run as a single business by Lord Balfour during the relevant period before his death or as two separate businesses, one run by Lord Balfour and the other by the trustees. If it was a single business, the next question was whether, in view of the letting income, it consisted 'wholly or mainly of the holding or making of investments', which would preclude the availability of BPR.

## THE JUDGMENT

The tribunal judge held that Lord Balfour had run the estate for his own benefit, for the preservation of the estate and for his future heirs and, regardless of the administrative and accounting arrangements, had managed it as a single business:

“To that end, he used assets of the trust estate in the business activities being carried on at Whittingehame. He took *de facto* responsibility for running all aspects of the Estate. He either made the business decisions himself or made recommendations to the Trustees which he expected them to approve and they invariably did so. The Trustees rarely met and appeared to be entirely passive. The Trust solicitors appear to have dealt mainly with Lord Balfour on estate matters. This is all consistent with Lord Balfour running the Estate as a whole.”

He went on to observe that throughout the relevant period, Lord Balfour had either been the liferenter carrying on the business as a sole trader or in partnership in which the property vested in him in 2002 formed part of the capital of the partnership. Overall, he was therefore content that that there was a single business, notwithstanding the fact that the trust was a separate entity, that Lord Balfour's interest in the partnership with his nephew had replaced the previous business carried on by him and that the BPR ownership test had been satisfied.

Turning to the issue of whether the single business consisted wholly or mainly of making or holding investments, the tribunal judge considered where the preponderance of business activity was. With reference to the approaches taken in *Farmer v IRC* (1999) and *IRC v George* (2003), he confirmed that the business activities needed to be looked at in the round and that there were a variety of relevant factors in creating an overall picture including turnover, profit, expenditure and time spent by everyone in the carrying on of the various activities. On the facts, he considered that the letting side at Whittingehame was ancillary to the farming, forestry, woodland and sporting activities and that the farming activities, albeit that they included agricultural tenancies, occupied the greater area of the Estate.

His following comments were particularly striking:

“My impression is that the management of a landed estate such as Whittingehame Estate even where a significant amount of the income is derived from letting income is, overall, mainly a trading activity. That is where the preponderance of activity and effort lies.”

Consequently, the judge held that the business activities carried on at the estate did not consist wholly or mainly of making or holding investments and that BPR was available for the whole.

## CONCLUSIONS

There is no doubt that this is an important case for landowners. The tribunal judge made some very encouraging comments, not least by stating that any suggestion that the activities carried on at Whittingehame comprised wholly or mainly of making or holding investments was “to belittle the efforts required properly and profitably to manage the various components of an estate of this nature.”

It should be noted, however, that that at the time of writing HMRC have not decided whether to appeal the decision. They are also generally looking into BPR claims much more closely these days, so it is essential that landowners should take steps to ensure that they can present the strongest possible case when the time comes. The following points may be considered:

- Have a single management structure and accounts covering the entire estate business rather than accounts for separate estate departments.
- Make sure that staff are not employed to look after the lettings side of the business alone – involve them in trading elements of the business as well, for example farming, forestry and sporting.
- Where possible, increase trading activity on the estate as against investment activity, for example by making surplus cottages available as holiday lets rather than on assured shorthold tenancies (although note that HMRC are currently reviewing their guidance on this).
- Ring fence assets which are obviously investments, for example by transferring them to separate trusts.
- Consider and bear in mind comparable cases, particularly within the same locality, which could be submitted by way of supporting evidence in a claim for BPR.

This briefing offers general guidance only. It reflects the law as at October 2009. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

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