NELSON DANCE: THE HIGH COURT CONFIRMS THAT 100% BPR MAY APPLY WHERE THE VALUE TRANSFERRED IS ATTRIBUTABLE TO TRANSFERS OF ASSETS USED IN A BUSINESS

by Marika Lemos

Business property relief ("BPR") has often been thought of as a relief applicable to transfers of different categories of property. The danger with this approach is that it wrongly focuses attention on identifying the nature of the property transferred and on whether or not it meets the definition of "relevant business property" contained in s. 105 of the Inheritance Tax Act 1984 ("IHTA"). Instead, the correct approach is to identify the transfer of value that has resulted in a reduction in the value of "relevant business property" in the transferor's estate, regardless of whether an actual transfer of the "relevant business property" takes place: so held the High Court, upholding the decision of the Special Commissioners in the case of the *Trustees of the Nelson Dance Family Settlement* v *HMRC* ("*Nelson Dance*").[1]

The significance of the *Nelson Dance* decision is that it upset what was previously thought to be the position regarding 100% relief for assets falling within s.105(1)(a) IHTA ("property consisting of a business or an interest in a business"), namely that BPR did not apply to transfers of individual assets of a business. It was thought that it applied only to a transfer of the whole of a business or an interest in a business.[2] From *Nelson Dance*, it is now clear that assets that previously formed part of the transferor's business qualify for relief. For example, where the property transferred is agricultural property, and agricultural property relief ("APR") is limited to the agricultural value of the land, it is now clear that, provided all the other relevant conditions are satisfied, 100% relief will apply to the development value of the land, i.e. the value in excess of the agricultural value, which was attributable to the transferor's "relevant business property".

Nelson Dance: the facts

The decision in *Nelson Dance* was on a preliminary issue. Consequently, for the purposes of hearing the preliminary issue, facts were agreed as follows:

(1) Nelson Dance ("Mr Dance") made a transfer of value, as defined in s.3 IHTA ("the Transfer of Value") on a date as yet unconfirmed in late 2002 or early 2003 ("the Transfer Date").

(2) Immediately prior to the making of the Transfer of Value, Mr Dance owned and carried on the business of farming as a sole trader ("the Business").

(3) (i) The Business did not consist wholly or mainly of one or more of the following, that is to say dealing in securities, stocks or shares, land or buildings or making or holding investments;

(ii) Mr Dance owned the Business throughout the two years immediately preceding the Transfer of Value;

(iii) The Business was not subject to a binding contract for its sale at the time of the Transfer of Value.

(4) The assets used in the Business included land and buildings ("the Land and Buildings"), namely some 1,735 acres of agricultural land near Andover, Hampshire, consisting of Upper and Middle Wyke, Finkley Manor Farm and East Anton Farm, Icknield Way plus two cottages - Nos 1 and 2 East Anton Farm Cottages.

(5) Prior to the Transfer of Value Mr Dance executed a settlement (the Nelson Dance Family Settlement ("the Settlement")) upon discretionary trusts such that the property which came to be comprised in it was "relevant property" as defined in s.58 IHTA 1984

(6) On the Transfer Date, Mr Dance executed two declarations of trust ("the Declarations of Trust"), by virtue of which East Anton Farm comprising approximately 141 acres and the two cottages Nos 1 and 2 East Anton Farm Cottages and part of Finkley Manor Farm became held upon the trusts of the Settlement.

(7) The Declarations of Trust gave rise to the Transfer of Value.

(8) The land transferred to the Settlement qualified as agricultural property for the purposes of s.116 IHTA, was occupied by Mr Dance for the purposes of agriculture throughout the period of two years ending with the date of the Transfer of Value, and was not subject to a binding contract for sale at the time of the Transfer of Value.

(9) Upon the Transfer of Value, Mr Dance did not transfer a business or an interest in a business to the Trustees.

(10) Mr Dance died on 1st April 2004.

On those facts, HMRC had issued a Notice of Determination to the effect that none of the value transferred was attributable to the value of "relevant business property" so that BPR under s.104 IHTA did not apply. The Trustees appealed to the Special Commissioners against that determination; a preliminary issue was directed to be heard; and the Special Commissioner Dr John Avery-Jones ruled in favour of the Trustees: the appeal was allowed and the determination was quashed. HMRC appealed to the High Court, where the preliminary issue was stated as follows:

> "Whether on the facts agreed or assumed [above], BPR was available on the value transferred by the Transfer of Value (defined [above]) (i.e. the transfer of value associated with the creation of the Nelson Dance Family Settlement by the transfer of the relevant property into the hands of the Trustees)."

The Trustees' case

Statutory scheme: loss to donor

The Trustees' case focused on the statutory scheme of the IHTA and in particular, the 'loss to donor' principle. Under the IHTA, tax is charged on "value transferred" by a "chargeable transfer" (s.1). The Trustees argued that both to establish that a transfer of value has occurred and to quantify the amount of the transfer, the relevant focus is on the reduction in the value of assets in the transferor's hands and not on any increase in the value of assets held in the hands of the transferee (ss.2 and 3 IHTA). This, the Court held, is reflected in s.3(3) IHTA which makes special provision for cases where the transferor acts, or omits to act, in ways that reduce the value of his estate.[3] Counsel for the Trustees drew the Court's attention to that fact that various of the exemption provisions in Part II of the IHTA operate by express reference to what happens to the assets of the transferee in relation to the disposition.[4] He argued that the fact that the intention to focus on what happens to assets in the hands of the transferee is made express in these particular provisions reinforces the impression that the 'loss to donor' principle is the general governing principle.

Section 104 IHTA does not make it relevant to look at the assets in the hands of the transferee. It provides for BPR in the following terms:

> "(1) Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property, the whole or that part of the value transferred shall be treated as reduced:
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> (a) in the case of property falling within section 105(1)(a) (b) or (bb) below, by 100 per cent;
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> (b) in the case of other relevant business property, by 50 per cent;
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> but subject to the following provisions of this chapter.
>
> (2) for the purposes of this section, the value transferred by a transfer of value shall be calculated as a value on which no charge is chargeable."

In effect, it was argued that, for the purposes of determining the availability of BPR, whether or not the business or part transferred should continue as a business in the hands of the transferee was a red herring.

The concept of a business as a form of 'property' for the purposes of BPR

In the case where a person carries on a business, it is, for the purposes of s.105(1)(a) IHTA, the business (or the interest in the business) which is treated as the "relevant business property", rather than individual assets owned and used within the business. This interpretation is reinforced by s.106 IHTA which provides that "property is not relevant business property unless it was owned by the transferor throughout the two years immediately preceding the transfer": s.106 cannot be referring to individual assets of the business.

Counsel for the Trustees referred also to s.110(b) IHTA. In providing that "the net value of a business is the value of the assets used in the business (including goodwill) reduced by the aggregate amount of any liabilities incurred for the purposes of the business", sub-paragraph (b) indicates that it is necessary to take into account the assets used in the business in valuing business as a form of business property. It was common ground that the land transferred by Mr Dance was used in his farming business up to the point when it was transferred. It was therefore part of the value of that business for the purposes of IHTA.

Attributing the value transferred to relevant business property

The real bone of contention was how the value of the land should be attributed, and in particular whether the transfer of value associated with the transfer of the land was to be regarded as attributable to the value of Mr Dance's farming business (which itself constituted "relevant business property" under s105(1)(a) IHTA) at the time of the transfer.

Counsel for the Trustees submitted that the value transferred might be regarded as attributable both (a) to the value of Mr Dance's farming business as conducted by him immediately before the transfer (i.e. to "relevant business property") and (b) to the value of the land transferred (which would not be "relevant business property"). It did not matter that value could be attributed to both since s.104 IHTA did not require a choice to be made exclusively between one category or another. For example, s.112 (excepted assets) IHTA indicated that the draftsman contemplated that the value of particular assets could be attributable to "relevant business property" (such as a business) and also to assets themselves. The determining point was the fact that the assets, i.e. the land, had been used in the business: the value attributed to it fell, by virtue of s. 110 IHTA, to be attributed to the value of the business.

HMRC's case: attributing the value transferred to the value of the land

Counsel for HMRC argued that, on a proper application of s.104, a choice does have to be made about whether the value transferred by the transfer of value was attributable to the value of Mr Dance's farming business or was attributable to the value of land, and that this was supported by the way in which ss. 199 (liability, disposition by transferor), 216 (delivery of accounts), 227 (payment by instalments – land, shares and businesses) and 237 (imposition of charge) IHTA are drafted and fall to be applied. In the context of the arrangements created by Mr Dance, the operation of those other provisions, which were expressed, Counsel for HMRC argued, in materially similar terms to s.104(1) IHTA, indicated that the draftsman assumed that the choice of characterisation does have to be made and that the proper characterisation was that this was a transfer of value attributable to a transfer of land.

Court's analysis

While acknowledging that if a characterisation was required, it was more natural to characterise the asset transferred by Mr Dance as land, Mr Justice Sales considered the Trustees arguments to be correct[5] for the following reasons:

(1) The Trustees' arguments had the merit of according simplicity and certainty to the statute, by contrast with the approach

proposed by HMRC. He considered that the draftsman too had opted for simplicity in using the concept of a 'business' as a form of property distinct from its assets. He considered that the "rather convoluted formula in s.104(1) IHTA (whether the value transferred by a transfer of value 'is attributable to the value of any relevant business property' - rather than simply saying 'is attributable to any relevant business property')" involves, in the case of a business, direct cross-reference to the simple test in s.110 to determine whether the value transferred is attributable to the value of the business".[6] He pointed out that the test in s.110 can readily be applied before and immediately after the disposition, to give a change in the value attributable to a business, in harmony with s.3(1).

(2) He accepted Counsel for the Trustees' submission that the general scheme of the legislation was the 'loss to donor' principle which directs attention to what happens to the transferor's estate. A charge to tax does not turn on what happens to the property in the hands of the transferee, save where the legislation expressly provides to the contrary. He found that, rather than displace the general scheme of the legislation, the provisions of ss.104(1), 105(1)(a) and 110 IHTA reinforced it. This interpretation met the object of BPR, in that it encouraged the use of assets in a business right up until the time of transfer.[7]

(3) He agreed that s.112(1) tended to indicate that the value of particular assets could be attributable to "relevant business property" (such as a business) and also to assets themselves, and that accordingly, where the value was attributable both to the 'business' and to an 'asset', specific provision was required to remove the value associated with that asset from the operation of BPR.

(4) He accepted the submission for the Trustees that the construction of s.104(1) which provided for an application of BPR in relation to a business was more in harmony with the other instances of the application of BPR contemplated by s.105(1), than was the construction proposed by HMRC. He agreed that the emphasis is on the simple issue of whether the transferor's "relevant business property" decreased as a result of the transfer of value not what was the nature of the assets transferred looked at in isolation. Quoting the examples contained in the skeleton argument on behalf of the Trustees, Sales J did not consider that HMRC had any good reply to illustrations of the operation of s.105(1).[8]

As for the detailed arguments put forward by HMRC in relation to the IHTA provisions imposing liability and for administering and collecting the tax, Sales J was not persuaded. In general terms, he considered that such guidance as these provisions might provide could not outweigh the matters set out above as indicators of the true construction and operation of s. 104(1). He accepted that their intended operation and effect did not impinge upon the approach to the application of s.104(1) IHTA outlined

above. However, he did comment on the operation of certain of these provisions. Because he held that their intended operation did not impinge upon the approach to the construction of s.104 IHTA, his analysis in relation to those provisions is necessarily *obiter*. In the author's respectful view, Sales J may have taken the analysis too far.

'Business' as 'property' for all purposes of IHTA?

The author agrees with the analysis and conclusions reached in relation to the construction of s.104 IHTA: in her view, the IHTA does operate by reference to the 'loss to donor' principle, and the proposition that 'business' is treated as a class of 'property' to which value is attributable for the purposes of BPR is supported by the provisions affording that relief. But it is not a necessary corollary of this analysis that a 'business' is generally treated as 'property' for all purposes of the IHTA, as is suggested by Sales J in para [38] of his Judgment.

Sales J rejected the submission made on behalf of HMRC in relation to s.199 IHTA which (so far as is relevant) provides as follows:

> "(1) The persons liable for the tax on the value transferred by a chargeable transfer made by a disposition … are:
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> (a) the transferor;
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> (b) any person the value of whose estate is increased by the transfer;
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> (c) so far as tax is **attributable to the value of any property**, any person in whom the property is vested (whether beneficially or otherwise) at any time after the transfer, or who at any such time is beneficially entitled to an interest in possession in the property;
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> (d) …"

In essence, HMRC argued that for the purposes of s.199(1)(c) the reference to tax "attributable to the value of any property" is a reference, in this case, to the value attributable to the land transferred by Mr Dance to the Trustees, and not to the business which Mr Dance carried on (i.e. the property which was held to constitute the "relevant business property"). HMRC argued that the formulation of the words in bold above is similar to the formulation of the words in s.104(1), that the focus here is on the assets transferred, thus ensuring that the Trustees are among the persons liable for tax due in respect of the transfer to them. It was argued that this informed the relevant focus under s.104 (1) IHTA. The judgment records that similar points were made in relation to s.216 IHTA, and were rejected for similar reasons.

Deriving support for his analysis by what he described as the purpose of the provisions, namely to impose liability for the tax upon a range of persons, Sales J's answer to HMRC's argument was that tax may be attributable both (a) to the value of the property which is transferred (i.e. the land) and (b) to the value of property which is retained by the transferor (i.e. the business which the transferor continues to carry on): in effect, that the reference to "any property" in s.199(1)(c) IHTA could include a

reference to the property which was "relevant business property" for the purposes of s.104(1) IHTA.

The author respectfully disagrees with this analysis. The reference in s.199(1)(c) to "any property" need not apply to "relevant business property" i.e. to the property of the transferor, in order for the transferor to be among the range of persons caught by s.199: the transferor is made liable by s.199(1)(a) IHTA. S.199 does provide for an extended meaning of "property": it includes references to any property directly or indirectly representing it (s.199(5) IHTA), thereby introducing the concept of statutory tracing into the provisions of Parts VII and VIII IHTA. But unlike ss. 104 and 105 IHTA there is no provision extending the meaning of "property" to "relevant business property", and therefore to a 'business'. While there can be some overlap in the identity of the persons made liable under the different sub-sections of s.199, the desire to make the transferor liable, but as owner of the 'business', cannot be a justification for extending the meaning of "property" in this context in the manner that Sales J's analysis implies. In the author's view, the purpose of 199(1)(c) is to make any person to whom the value of property transferred can be traced liable for the tax. The absence of a reference to "relevant business property" means that this provision does not impact on the interpretation of s.104. But, unlike s.104, s.199(1)(c) IHTA is a provision for which the relevant focus is the identity of the transferee. This is determined by tracing the value of the assets transferred into the hands of the transferee.

HMRC also relied on s.227 (Payment by instalments – land, shares and businesses) to show that the relevant focus is the property in the hands of the transferee. Counsel for the Trustees agreed that the focus was on the property in the hands of the transferee in this section, but explained the reason for this in the context of the purpose of s. 227 IHTA, i.e. to provide relief in allowing payments by instalments in relation to liability to tax in respect of transfers of particular categories of property. This explanation was accepted by Sales J. It is important to note, that in a similar way to ss.104 and 105 IHTA, but in contrast to s.199 IHTA, a special category of property to which s.227 applies is defined, namely "qualifying property." A "business or an interest in a business" is "qualifying property" by virtue of s.227(2)(c) IHTA. In the author's view, this is further evidence that, save for instances where the legislation specifically so provides, a 'business' is not generally treated as "property" in the IHTA.

The precise meaning of "property" is particularly important in the context of s.237 IHTA, as it impacts upon the circumstances when a charge on property in respect of unpaid tax and interest can arise in favour of HMRC. Following on from his analysis in relation to s.199 IHTA, Sales J considers that s.237(1)(a) IHTA, which provides that a charge can be imposed on "any property to the value of which the value transferred is wholly or partly attributable", enables a charge to arise in favour of HMRC in relation to both the property transferred (i.e. in *Nelson Dance*, the land) and the business (i.e. the continuing business retained by Mr Dance). This analysis is justified on the basis that it follows the imposition of liability to pay the tax under s.199(1)(c) on both the transferor and the transferee.

The author disagrees with Sales J's analysis on the imposition of liability under s.199(1)(c). It is not surprising, therefore, that the author also disagrees with Sales J's analysis of s.237 IHTA. It seems that he reached his conclusion in relation to s.237

through backward reasoning, i.e. that because a charge could, as a matter of general law, be imposed in respect of the sales proceeds of a business, there is no reason why a business cannot be 'property' for the purposes of s.237. But there is, in his judgment, no analysis of the internal structure of s.237, nor any discussion of the statutory tracing and following which seem to be inherent in some of the mechanisms for imposing liability and administering and collecting the tax set out in Parts VII and VII of the IHTA. Analysing the provisions of Parts VII and VIII of the IHTA in those terms may have prevented Sales J from reaching the (albeit *obiter*) conclusion that he did.

Conclusion

There is no doubt that *Nelson Dance* is an important decision and one which is valuable to taxpayers.

Nelson Dance has changed the way that BPR has hitherto been understood to apply. The fact that there is no requirement under s.105(1)(a) IHTA that the asset transferred is itself a business means that BPR is unlike other reliefs in the context of VAT (transfer of a business as a going concern) and capital gains tax (roll-over relief) which relate to transfers of businesses transferred as going concerns.

In many cases, tax will have been paid or cumulative totals calculated on the understanding that BPR was not available. However, where tax has been assessed and paid, the inheritance tax prevailing practice provision (s.255 IHTA) is likely to prevent a successful claim for recovery of overpaid tax (under s.241 IHTA) and interest (under s.235 IHTA) from being made. Where tax has not yet been assessed and no amount has yet been paid in satisfaction of a liability (for example because the transfer was a PET or within the transferor's nil-rate band), cumulative totals can be recalculated to take into account the new understanding of the circumstances when BPR may apply.

The *obiter* remarks made in relation to s.237 IHTA are potentially problematic. If (though which it is hoped that they do not) HMRC do decide to rely on Sales J's reasoning as a basis for arguing that a charge under s.237 IHTA arises on the part of the business retained by the transferor, the taxpayer's case will, in the author's view, be the better one.

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[1] [2009] EWHC 71 (Ch)

[2] Textbooks on inheritance tax took the view that individual assets of a business could not fall within s. 105(1)(a) IHTA which affords 100% relief (see para. 10 of the Special Commissioner's decision [2008] STC (SCD) 792 for references to the relevant passages in three leading textbooks).

[3] In such a case, there is a 'transfer of value' only if the value of another person's estate or of any settled property (other than property treated by virtue of s. 49(1) as property to which a person is beneficially entitled) is increased and the omission was not deliberate.

[4] See ss.18 (transfers between spouses), 23 (gifts to charities), 24 (gifts to political parties), 25 (gifts for national purposes) and 30 (transfers where exemption depends upon the giving of an undertaking by the transferee as to what will be done with the transferred assets) IHTA.

[5] Paragraph 22 of the Judgment makes clear Sales J's preference for the arguments put forward by Counsel for the Trustees: in a short paragraph, the word 'correct' appears three times.

[6] At para 23.

[7] Note that at first instance HMRC had attempted to introduce passages in Hansard which, it was argued, showed that the purpose of BPR was to enable a transfer of a whole business to successors (see para. 9 of the Special Commissioner's decision). Special Commissioner John Avery-Jones did not see any ambiguity in the legislation and did not therefore consider it necessary to consider Hansard (see para. 17). There is no indication in the judgment of the High Court that there was any disagreement about the purpose of BPR, described at para [26].

[8] The examples are not reproduced in this article, but are a useful illustration of the operation of BPR in different factual circumstances.