Analysis

Structuring following the new rules for IHT business and agricultural property reliefs

Speed read

The Autumn Budget has announced significant changes to the IHT reliefs for business and agricultural property, known as BPR and APR from 6 April 2026. From that date each taxpayer will have a £1m combined allowance for these reliefs, covering assets that qualify for 100% relief up to that value. Assets above this value will qualify for 50% relief where full relief previously applied. The changes will particularly impact farming businesses and other high-value businesses. Affected businesses will need to claim a combination of APR and BPR to be fully relieved from IHT charges, and those contemplating restructuring should take advantage of available CGT reliefs. The new rules may require more sophisticated partnership agreements and diversified ownership to optimise tax positions. The proposed changes are controversial and there will be lobbying against them. However, the focus of this article is on the technical and practical ramifications on the assumption that the proposals are duly enacted.

Michael Thomas KC
Pump Court Tax Chambers
Michael Thomas KC is a barrister at Pump Court Tax Chambers. He advises and litigates on all areas of the UK tax code. Michael has particular experience in matters related to real estate, corporate tax and indirect taxes. Email: mjthomas@pumptax.com.

So, the Halloween Budget has taken a scythe to the key IHT reliefs for both business and agricultural property, 'BPR' and 'APR' respectively. Longstanding fears that these reliefs were to be curtailed have been realised and the changes will take effect from 6 April 2026, with some anti-forestalling rules.

The new rules are summarised in last week's edition of this journal ('Autumn Budget 2024 report', *Tax Journal*, 1 November 2024). In summary, each taxpayer will have a £1m combined allowance for both BPR and APR. This will cover assets which qualify for 100% relief up to that value. The allowance covers both lifetime transfers and transfers on death (including failed potentially exempt transfers (PETs)). Assets above that value will qualify for 50% relief where full relief would previously have applied. Assets which qualify for the 50% rate of relief on the current law will be unaffected. Trusts will each have a £1m allowance, although that will be aggregated to the extent that property is put into trust on or after 30 October 2024 to prevent the rule being unduly exploited. A consultation in 2025 will be undertaken to provide the technical detail on how the charges will apply to trusts. In addition, the 100% rate of BPR currently available for AIM shares will be reduced to 50%.

Current position

Both BPR and APR are subject to detailed conditions and a full discussion is outside the scope of this article. Readers are referred to the relevant legislation, contained in IHTA 1984 Part V Chapters 1 and 2, together with the relevant commentaries, including HMRC's Manuals. Nevertheless, when considering the impact of the changes, it is important to set these in context and the following points should be noted.

On the current law, BPR is a generous relief and it is not surprising to see it curtailed. At present, BPR enables an individual to buy qualifying assets, including AIM shares and commercial woodlands, and providing she survives for two years then this value is relieved from IHT. Moreover, an interest in a company or partnership where the preponderance of the activity is trading, providing that the trade is not dealing in land or shares, qualifies for 100% BPR even if there is a significant amount of investment activity within the company or business. In both of these cases, the CGT death uplift applies so there is rebasing on death.

APR is less generous. It only relieves agricultural land together with farmhouses and cottages which are of a character appropriate to that land and are occupied by someone involved in farming. Farm cottages let to third parties do not qualify for APR. Only the agricultural value is relieved. Where farmland is let then relief is restricted to 50% unless the tenancy began on or after 1 September 1995 or the owner has the right to obtain vacant possession within the next 12 months. The distinction between tenancies granted before and after September 1995 might have made some sense when IHTA 1984 s 116 was enacted but it is now anomalous and causes taxpayers to enter into surrender and regrant transactions, with the additional complexity and scope for potential charges which that entails.

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Practical impact of the changes

The practical impact of the above rules is that farming businesses are at present required to claim a combination of APR and BPR in order to be fully relieved from IHT. Farmhouses are generally excluded from BPR. However, in order to relieve cottages let on the open market, which are commercially important if not essential to many family farms, the business as a whole must qualify for BPR. Businesses whose main activity is farming should qualify for BPR. The key authority is *Brander (representative of Earl of Balfour) v HMRC* [2010] STC 2666.

In order to understand what future structures might look like, it is necessary to consider the remaining IHT rules which taxpayers might seek to utilise to their advantage.

First, 100% relief under any combination of BPR and APR will generally remain available in its current form for £1m of value and will be reduced to 50%, for the same assets, thereafter. The exception is that AIM shares will only attract relief at 50%, other low risk investments (including commercial woodlands and BPR funds) should attract 100% relief. The Budget was a bad day for AIM listed companies but a good day for those who sell units in commercial woodlands and other BPR funds. Despite the suggestion of the former Office of Tax Simplification (OTS) that the test for BPR should be aligned with less generous CGT reliefs, in an apparent deviation from its impossible remit, only the majority of economic activity within a company or business still needs to comprise qualifying trading activity in order for the entire value within it to be relieved.

Secondly, the £1m allowance is available for each individual taxpayer. Accordingly, diversifying ownership will become an increasingly important strategy. Those impacted by the restrictions to APR and BPR, notably farming businesses, will now need to consider this where it would have been unnecessary previously. That may mean, for example, that more sophisticated partnership agreements are put in place. Where more complex arrangements are utilised (such as where income and capital shares in a partnership vary), care must be taken to ensure that adverse tax consequences are not triggered.

Thirdly, the ten-year anniversary and exit charges under the IHT relevant property regime for trusts are at a maximum 6%, or 0.6% per year. Where BPR and APR apply in their new reduced form, those rates will be halved – leaving an effective annual charge of 0.3%. It might be argued that such a charge should be a manageable cost of business. In response, it might be said that businesses, and notably farming businesses which perform an important function and frequently struggle to make a profit, are being made subject to an effective wealth tax which does not apply to those investors who, unlike farmers, are free to give value away. In any event, the rates remain favourable.

Fourthly, the proposed transitional rule appears to enable unlimited transfers into trusts to be made prior to 6 April 2026 with the benefit of BPR and APR. As long as the transferor survives the seven year period or dies before 6 April 2026, no IHT will arise. It appears that a death after 6 April 2026 within the seven year period will cause the new £1m limit to be applied to the lifetime transfer, triggering IHT on death.

Fifthly, rural businesses should consider the availability of other reliefs. The conditional exemption for heritage property relief may be worth considering where the owner is willing to permit some public access. Woodlands relief under IHTA 1984 s 125 will now need to be considered in its own right, though this is only available on death and is more limited in the relief available.

Back to the basics

Finally, it is essential not to overlook the basics. Indeed, IHT is a simple tax to avoid. An individual need only give his or her assets away and hope to survive seven years, with the rate starting to taper after four years where the nil rate band is exceeded. The difficulties in avoiding IHT are principally three-fold.

First, death can strike at any time. So even where a gift is made by an individual with a decent life expectancy, a charge can still be triggered. Premature death might be hedged against with life insurance, which will come at a cost, although this may be relatively modest depending on age. Where an individual is married, the spouse exemption can be utilised to enable the surviving spouse to make gifts where the deceased has not.

Secondly, if the individual needs the assets to live off, they cannot be given away. Planning aimed at individuals continuing to use an asset, in particular residential property, whilst taking it outside their estate for IHT purposes has given rise to significant amounts of anti-avoidance provisions including especially the gifts with reservation of benefits rules in FA 1986 and the pre-owned assets income tax charge in FA 2004. This point is central to the concerns raised by farmers in relation to the changes. Whatever structures are now to be adopted, such as sophisticated partnerships, these will likely require detailed consideration of the application of the gifts with reservation of benefits rules.

Finally, disposing of assets can trigger charges to CGT. This is a significant obstacle to IHT planning. Taxpayers will typically want to avoid triggering such 'dry' CGT charges, where tax is payable but no funds are generated from any sales. As the last statutory rebasing for most assets was in 1982 and land prices have significantly increased in recent years then gains may be very significant in respect of many farms. This is therefore a potential bar to restructuring for many farmers.

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CGT planning

Taxpayers contemplating restructuring will therefore want to consider the potential availability of CGT reliefs. There are two main reliefs which might assist. Each relief is summarised immediately below but, as always, these are subject to detailed conditions and readers are referred to the legislation and commentaries.

One is the holdover relief for gifts of business assets contained in TCGA 1992 s 165 and Sch 7. This covers gifts of assets used in trades, professions and vocations. The trade can be carried on by the donor or a company in respect of which the donor can exercise at least 5% of the voting rights. Partnerships of all kinds are generally treated as transparent. The relief also covers shares in trading companies; although the test is more restrictive than for BPR as a lower proportion of investment activity is permitted. The relief is extended by Sch 7 to assets which qualify for APR.

The other is the holdover relief contained in TCGA 1992 s 260 for transfers into and also out of trusts. The trust must not be settlor-interested for this to apply on a transfer into trust. The relevant definitions mean that the settlor together with any spouse or minor children cannot benefit from the trust.

From a planning perspective it must be noted that the tax-free CGT uplift of base cost on death remains in place, notwithstanding the further suggestion of the OTS in another digression from its failed remit, to the contrary. The government seems to have made the choice that IHT is the relevant tax on death and more monies should be levied at that time by restricting IHT reliefs.

Another relatively favourable aspect in relation to CGT is that although some rates have increased, the general rate for higher rate taxpayers and trustees is still only 24% and this rate continues to apply to residential property. If the planning rules are relaxed and land is able to be sold for development then some, but inevitably not all, farming businesses may be able to take advantage of this. This could be used to generate cash to pay any IHT arising.

Optimal solutions

Devising optimal structures for the future is likely to depend on how some of the capital taxes considerations outlined above can best be combined in light of the particular commercial circumstances. Income tax, SDLT and VAT issues will also need to be taken into account. There is unlikely to be a single solution which suits everyone. Nevertheless, some general points can be made which will be relevant to a very wide variety of circumstances.

Diversifying ownership of assets should help optimise the IHT position. This is not a new idea, but it will now need to be applied where previously some combination of BPR and APR would have applied a blanket exemption. Diversifying ownership and passing wealth down generations tends to favour economic growth and is one of the policy aims which underlie IHT.

Investors can still use BPR and APR to shield up to £1m of value entirely and to halve the rate of IHT to 20% on values above that amount. Combined with the CGT death uplift this can be viewed as a favourable tax regime. It should not be overlooked that the IHT charge on death or failed PETs is never borne by the deceased and the combination of reliefs together with the nil-rate bands enables significant values to be transferred with little or no tax. Ignoring lifetime gifts which become successful PETs then a married couple should be able to transfer £2.65m (and potentially up to £3m) of value free of IHT and with CGT uplifted base costs. From the perspective of any recipient, this compares very favourably with the tax rates on earned income.

Those with a choice where to invest can maximise BPR by moving out of AIM shares and into other qualifying investments. Buying a small farm or some let farmland remains a potentially effective IHT shield. Ironically, if the aim of the changes was to target those who invest in business assets and farms primarily to save IHT, then the revised rules do not achieve that especially well.

Again, perhaps ironically, the changes now make trusts more attractive vehicles for holding assets which are now exposed following the changes to BPR and APR. A 0.3% effective annual charge may be considered more attractive than risking a 20% charge on death.

As has been the subject of much media attention, the changes to BPR and APR adversely impact businesses with a value of more than £1m. This applies especially to businesses which contain high capital values. Farms are the most obvious and high-profile example but the same applies to a manufacturing business which owns and operates from premises which have a significant value. The owners of these businesses make the point that they carry on the kinds of activities which should be encouraged rather than deterred and it is unfair to hit them with 20% charges when the owner dies, which may well result in assets being sold and the business being unable to continue in its present form, notwithstanding the ability to pay tax in instalments. There are political choices being made here which are outside the scope of this article.

For farms and other businesses in this situation then the aim of the game may now be to minimise IHT charges rather than avoid them entirely. A starting point may be to consider how ownership might be diversified, subject to what is feasible commercially. This leads into trying to take advantage of the CGT holdover reliefs referred to above. One issue concerning s 165 relief is whether this covers investment assets, such as farm cottages, which neither individually qualify for APR nor are used in any trade but which form part of a single title under which a working farm is held. Where s 165 relief is unavailable then it may be appropriate to look to s 260 relief to apply where assets are transferred into trust.

Farms and other businesses are now more likely to use complex structures to try and save tax. As noted above, trusts may be considered efficient vehicles for minimising IHT charges. Another strategy may be to involve companies with future growth passing down the generations through the use of freezer shares. More complex structures such as using companies, perhaps in partnership, and freezer shares are far from straightforward to implement successfully. The analysis for all taxes, including as regards anti-avoidance rules, must be very carefully considered in these kinds of situation. Examples of the issues to beware of include the gifts with reservation of benefits rules for IHT and the income tax rules for settlements and companies in partnership. If a company is involved and does not deal on arm's length terms, then other charges may arise.

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More generally, complex structures will inevitably involve advisory costs together with ongoing compliance and valuation issues will similarly increase costs. Where the analysis is less straightforward, there is inevitably greater scope for disputes and structures failing to achieve their aims for one reason or another. If nothing else, these changes have added another layer of complication to the UK's bloated tax code.

Where does this leave us?

Looking at the bigger picture, these restrictions form part of a progressively more onerous capital taxes landscape that has developed over recent decades. IHT is probably long overdue a full overhaul. Pending that, more tinkering can be expected. It does not take too much imagination to worry about future changes impacting the tax-free uplift of CGT base cost on death, the BPR test for composite businesses and the rate at which trusts pay IHT. One thing which can be said with confidence is that the future remains inherently uncertain. Accordingly, it is prudent to consider both diversifying ownership and adopting a combination of strategies to try and guard, as far as is possible, against future changes as well as known exposures to IHT. ■

The author thanks Helen Lewis, IHT, trusts and estates tax writer at Tolley, for her technical input.

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- Autumn Budget 2024: report (31.10.24)
- Autumn Budget 2024: IHT – APR and BPR reform (I Glyn & S Sears, 1.11.24)
- Back to basics: Section 260 holdover relief (P Townson & S Metha, 31.5.23)
- Back to basics: Section 165 holdover relief (C Holmes & P Townson, 9.3.23)