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APR and BPR: An Advocate's View

by

Philip Simpson

**Advocate ~ Barrister
Chartered Tax Adviser**

I. Introduction

1. The title of this paper includes the term ‘An Advocate’s View’. Perhaps the main feature of practice at the tax bar that distinguishes it from other types of tax practice is that more time is spent litigating, and the litigation often tends to be post-event disaster management rather than defending a well-planned structure. The purpose of litigation, at least in the tax field, is to persuade a judge to reach a particular conclusion, having regard to the law and the facts. In seeking to achieve this purpose, some facts are better than others. So part of the advocate’s task is to persuade a judge to find that the good facts occurred whereas the bad facts did not. For this, what is required is evidence. Accordingly, I am going to discuss what sorts of facts might have to be proved to a court, and what evidence one might adduce to try to prove them.

2. I shall divide this paper into four sections. The first section is general points about evidence. After that I shall discuss agricultural property relief, then business property relief, and finally minimum periods of ownership.

II. General points about evidence

3. Key to persuading a judge to find a particular fact is quality of evidence. So in general, a document is better than a witness, and an independent witness better than a party. But if there is to be any evidence at all, it is almost always necessary to have the taxpayer as a witness. Apart from anything else, the court may become suspicious if it

does not get the opportunity to listen to the taxpayer being cross-examined, and to ask him questions itself.

4. A second point is that one must be careful to ensure that one is taking to the court evidence to justify every finding in fact that one is going to seek. The only way to ensure this is hard work. Write down a list of all the facts you want to prove. This should include not only the principal facts that, according to the view you have taken of the law, entitle you to succeed, but also all the other facts that are consistent with and support those principal ones. Once you have done this, for every fact listed, identify the source of evidence you are going to rely on as proving that that fact occurred. Where the source is a document, identify the witness you are going to rely on for evidence that the document is genuine. For every source listed, consider whether there might somewhere be a better source. If there is, obtain it, and use it instead. If any better source is not available (for example a document has been lost or destroyed), be ready with, and give, the explanation as to why you do not have it.

5. When an expert is to be used, a number of factors must be considered. Principal among them is that the expert should have the right expertise. But in addition, the matters about which the expert is to give his opinion must be clearly identified to him.

6. Finally, make sure that you have enough copies of the documents for everyone who is going to be at the hearing. This is normally at least four. One for yourself, one for the judge (if there is more than one person sitting, then one for each of them), one for the witness, and one for the other side. Lodge the copies for the judge and for the witness a few days in advance of the hearing, so that the judge can read them in advance if he

wants, and so that on the day the clerk will have the documents in order and ready to be handed up to the witness when required during examination.

III. Agricultural property relief

7. In the past two or three years, the battleground in APR has been the farmhouse. Agricultural property is defined so as to include, 'such cottages, farm buildings and farmhouses, together with the land occupied by them, as are of a character appropriate to the property'.¹ Whether this is because large landowners are nowadays less likely to be involved in the actual farm activity, having acquired the property by earnings from highly-paid jobs in the City rather than by inheritance, is not clear. In any event, the Revenue has challenged the entitlement of so-called 'lifestyle' farmers to APR on the value of their (farm)houses.

8. The theory is that if the landowner does not actually get involved in the farming activity, then the house is not a farmhouse at all; and even if the landowner does get involved, if his involvement is little, or the part of the farmhouse used for the purposes of the farming activity small, then the farmhouse may not be 'of a character appropriate to the property'.

9. Certainly, the first part of this theory has been accepted by various tribunals in recent cases.² So to be a 'farmhouse', a building must be the chief dwelling-house

¹ Inheritance Tax Act 1984 ('IHTA 1984'), section 115(2).

² See *Lloyds TSB Private Banking plc v. Twiddy* [2005] EWLands DET_47_2004 ('*Antrobus II*'), and *Arnander and others v. Commissioners for Her Majesty's Revenue and Customs* [2006] UKSPC SPC 000565.

attached to a farm, and be the dwelling-house of the farmer who manages the farm. Whether these conditions are satisfied must be decided in each individual case.³ The dispute is likely to revolve around two separate propositions.

10. While it is easy enough to establish whether a building is the chief dwelling-house attached to the farm, it may be more difficult to establish that it is the dwelling-house of the person who is said to live there. For example, a person may work in town, and live there during the week, while coming to the country for weekends. It will have to be shown that not only the quantity but also quality of time spent in the farmhouse is sufficient to make it a dwelling, rather than simply a second ‘home’ for holidays at the weekends. This issue has not yet been considered by the courts.

11. Starting with quantity, a day count is helpful, showing the number of days spent at the farm; but what might be better is a night count.⁴ Although it is unlikely that there will be any records on which to base such a count (unless the person has kept a diary and recorded such matters in it), the exercise should none the less be undertaken. Assistance should be obtained from other people within the individual’s immediate circle, in particular any family members who live with the person.

12. But quality of residence is also important. For example, it is useful if the person’s family lives in the farmhouse, particularly if they live there all the time; if there is a circle of friends local to the farm, and more generally if the person is well-integrated into the

³ *Arnander*, paragraph 80.

⁴ See the means by which the Revenue increased the amount of time spent by the taxpayer in the United Kingdom in the case of *Gaines-Cooper v. Commissioners for Her Majesty’s Revenue and Customs* [2006] UKSPC SPC000568.

local community; if entertaining, particularly of family, or of friends from town, tends to be done at the farm rather than in town; and so on.⁵

13. The second aspect is whether the person is actually the ‘farmer’. This boils down to the degree to which the person is involved in the actual work of the farm. At one end of the spectrum is Miss Antrobus, who regularly got her hands dirty,⁶ at the other, Mr McKenna, who did little more than keep some records and walk around the farm, for about an hour each day.⁷ So it is important to obtain as much evidence as possible of any bits of real farm work that the person did. This is most likely to come from the other individuals working on the farm: was the person ever seen to plough a field?, to drive a tractor?, to harvest a crop?, to shear sheep, brand cows, or feed chickens? This evidence should be obtained for as long a period as possible. Even if irregularly, or even if only at weekends, this type of evidence may turn a McKenna into an Antrobus. In addition, it may be the case that at the material time the person was somewhat older, and was in fact not doing much by way of physical work. But in that scenario, it may be enough to distinguish *McKenna* (where the transferors involved had never worked the farm themselves, having always contracted that out) if the person used to do sufficient physical work to have been at one time regarded as the farmer, and is still sufficiently involved in the business of the farm still to be regarded as such by those who do the actual work.⁸

⁵ Ideas of what sort of evidence might be helpful may be obtained from the decision in *Gaines-Cooper*.

⁶ See *Lloyds TSB Bank plc v. The Commissioners of Inland Revenue* [2002] UKSC SPC000336 (‘*Antrobus F*’), in particular at paragraph 25.

⁷ *Arnander*, paragraphs 59 to 62.

⁸ See *Rosser v. Commissioners of Inland Revenue* [2003] UKSC SPC00368, in particular at paragraphs 16, and 52 to 54, where the person had ceased to be involved in any real way at all in the farm. Accordingly, despite the history of the use of the building, it was not a farmhouse.

14. The second part of the theory concerns whether the farmhouse, once found to be such, is ‘of a character appropriate to the property’. The ‘property’ in question is the bare land that is used for agricultural purposes.

15. What can be very impressive are photographs. In particular, it seems that the ‘elephant test’ is peculiarly relevant to the issue,⁹ and this of course cannot be satisfied unless the house and the property it is attached to are seen.

16. Another test relevant to the issue is whether the educated rural layman would regard the building as being of a character appropriate to the land.¹⁰ Thus, unusually, it is legitimate, and even necessary, to ask lay witnesses their opinion on a factual matter. So when examining any witnesses on other parts of the case, for example farm workers on how much physical work the person in question did on the farm from time to time, one should also ask them whether, in their opinion, the building was appropriate to the land in terms of character.

17. But more mundane facts are also relevant, for example details of the accommodation in the house and how much of it is actually used for farming business;¹¹ the amount of land farmed; the history of the use of the building; and so far as can be obtained equivalent details of comparable farms in broadly the same geographical location.¹² The latter evidence will be spoken to by an expert, usually a surveyor.

18. Ultimately, the matter is impressionistic. It may be that the most persuasive piece of evidence would be a visit to the farmhouse.¹³ The fact that it is impressionistic makes

⁹ See in particular *Antrobus I*, paragraphs 47 and 48; *Rosser*, paragraph 56.

¹⁰ See *Rosser*, paragraph 57.

¹¹ See *Antrobus I*, paragraphs 9 ff.; *Arnander*, paragraphs 18 ff.

¹² See in particular *Antrobus I*, paragraphs 34 ff.

¹³ This is what was done in *Antrobus II*: see paragraph 2 of the decision.

it all the more important to get all the available evidence ready for the fact-finding tribunal, because it will be very difficult to persuade a higher court, when appealing on a point of law, to overturn the decision at first instance.¹⁴

19. Finally, valuation. It is important to remember that APR is not simply given on the full market value of the agricultural property. Instead, the land and buildings must be valued on the hypothesis that their use is subject to a covenant that for all time coming they shall be used for agriculture only, and not for any other purpose.¹⁵ The main consequence of this is that development, or hope, value, is left out.¹⁶ It is therefore necessary to provide evidence of what the so-call ‘agricultural value’ of the property is. The Revenue will provide an opinion by the District Valuer. The taxpayer needs evidence from a surveyor, and in particular one having experience of valuing farms as such. Of course, there is nothing to stop the taxpayer from obtaining opinions from two or three surveyors, and choosing to use only one of them as a witness.

IV. Business property relief

20. The United Kingdom tax regime recognises four different types of business, namely trade, profession, vocation and investment.¹⁷ But the tax authorities do not seem

¹⁴ See *Edwards v. Bairstow* [1956] A.C. 14.

¹⁵ IHTA 1984, section 115(3).

¹⁶ See, for example, *Taylor v. Commissioners of Inland Revenue* [2003] UKSC SPC 00363, per the Special Commissioner at paragraph 11.

¹⁷ *Jowett v. O’Neill* [1998] S.T.C. 482, per Park, J., at 489; approved in *Commissioners of Her Majesty’s Revenue and Customs v. Salaried Persons Postal Loans Limited* [2006] EWHC 763 (Ch), at paragraphs 30 ff. per Lawrence Collins, J.

to regard investment as quite so deserving of tax advantages as the other types of business. Hence, we find the following in IHTA 1984:

‘A business or interest in a business, or shares in or securities of a company, are not relevant business property if the business or, as the case may be, the business carried on by the company consists 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.’¹⁸

21. In recent years the front line has been drawn at land, and in particular at caravan parks. The issue has been whether businesses whose activities include letting pitches for caravans, or flats for people to live in, are investment businesses, and thus excluded from business property relief. Curiously, there seems no doubt that, for example, plant hire, and shipping and aircraft leasing businesses, which perform economically the same function but in relation to moveable, depreciating assets, are trades. This suggests that one of the overall issues is whether the nature of the asset and the use to which it is put are such that one of the primary purposes of the business can be regarded as being the obtaining of a capital profit from the assets used by the business. This accords with the list of assets identified as excluding a business from relief, namely securities, stocks, shares, land and buildings. Unlike most other assets used in commerce, their value can go up as well as down. The consequence is regarded by the courts as being that obtaining an income return from the normal exploitation of such assets is an activity excluded from relief. This view also suggests that one area of dispute in the future may be storage activities.¹⁹

¹⁸ IHTA 1984, section 105(3).

¹⁹ See *George v. Commissioners of Inland Revenue* [2004] S.T.C. 147, paragraphs 31 ff., where caravan storage was held to be investment activity.

22. In any event, it seems clear (although the courts have not yet decided the point) that an activity consisting in renting out land is investment for the purposes of the relief.²⁰ Once one finds such an activity, the question is whether it constitutes the whole or main part of the business. To answer this question, one must look at all of the relevant facts and circumstances.²¹ As has been said in the Court of Appeal, ‘One consequence of the relative imprecision of the statutory test is that the right to business property relief may depend on fine distinctions between businesses, which, to their owners, and for most practical and economic purposes, are virtually identical.’²²

23. The first point to consider is what else the business does. Once identified, the aim is to seek ways of maximising the importance of that other activity, so far as it consists of a trade, profession or vocation, in the context of the business as a whole, and certainly of making it seem far much more important than the investment element of the business.

24. One aspect of this is purely financial information: how much profit, gross and net, do the respective parts of the business make? what is their turnover? how much expense is incurred? what are the ratios of cost of sales to turnover, and of total expenses to turnover? In a well-organised group of companies, it is likely to be straightforward to obtain most of this information from the accounts of the various companies,²³ but where everything is done through a single company, detailed investigation of the financial

²⁰ Having said that, in *George*, which is the leading case in recent times, it was simply agreed before the Court of Appeal that property letting was investment, and the point was not argued: see paragraphs 10 to 12.

²¹ *Farmer v. Inland Revenue Commissioners* [1999] S.T.C. (S.C.D) 321, at 329 per the Special Commissioner (Dr Brice); approved in *George*, paragraph 13, and *Clark*, paragraphs 11 f.

²² *George*, paragraph 3.

²³ It may in any event be wise to separate out mixed businesses into different companies, to ensure that the trading part at least of the business attracts the relief.

records will be necessary. One may have to use the company's accountant as a witness to explain what the financial records show.

25. A second aspect is time: how much directors' time is spent on the investment and on the non-investment sides, and how much employees' time? In the absence of timesheets, directors will have to be closely questioned on their activities, on how many employees are used in each side of the business, and on what percentage of those employees' time is spent on the different types of activity.²⁴

26. A third issue is the relationship of the two different activities to each other: is one undertaken purely in support of the other, being ancillary to it, or are they independent activities? And if the trading activity is carried out in support of the investment activity, is the same thing done also for third parties (for example, cleaning flats)?²⁵ In addition, one might ask whether one side subsidises the other side and, if so, why? Furthermore, it is relevant how the activities are structured, and in particular whether they are separately invoiced, and whether trading partners of the investment element of the business can choose whether or not to take the services that comprise the non-investment element, both in the sense of choosing whether to obtain such services at all, and in the sense of whether to obtain such services from the business or from some other entity. So the terms on which the business contracts will be relevant.

27. The fourth consideration is the history of the business. What did it start out as? How and when has the business changed over its existence? For example, a farming business that has spread its risk by buying some flats to rent out is less likely to be

²⁴ See *George*, paragraph 38.

²⁵ See generally *George*, paragraphs 27 ff.

regarded as consisting mainly of investment, even if the flats are slightly more valuable, or produce slightly more profit, than the farm. So one will have to look at when the second part of the business started up, when the assets necessary for its use were acquired, when it started trading, and how, since then, it has compared in terms of size and importance to the original part of the business. So evidence from former directors (and sometimes from former employees), from previous financial statements, and from formal sources recording title to assets may be useful.

28. It is clear that all of this requires detailed statements from the main individuals involved. Given the context of inheritance tax, this may have to be extended to main employees. But in general, as much evidence as possible of all the facts one wants to prove should be obtained.

V. Minimum period of ownership

29. The final point to be discussed is a factor common to APR and BPR, namely minimum periods of ownership. So to attract BPR, the transferor must have owned the asset for at least two years;²⁶ for APR, the period is either two years' occupation, or seven years' ownership, if occupied by the transferor or someone else throughout that time for the purposes of agriculture.²⁷ There are relaxations of these rules for replacement of

²⁶ IHTA 1984, section 106.

²⁷ IHTA 1984, section 117.

property,²⁸ for succession on death,²⁹ and for successive transfers where a death follows an earlier transfer within two years.³⁰

30. With land, the evidence necessary to prove the date of acquisition is the title sheet (if held in the Land Register) or a copy of the registered deed, showing the date it was recorded (if still subject to the Register of Sasines register).³¹

31. With shares, the relevant record is normally the company's register of members,³² and this is open for inspection and copying by the public.³³ But if a person acquired shares on incorporation as a subscriber, then what is required is a copy of the memorandum showing that subscription and a copy of the company's certificate of incorporation, showing the date of incorporation. In that scenario, the date of acquisition is the date the company was incorporated.

32. For a business or an interest in a business, it is again straightforward if the asset has been acquired from a third party. The contract will identify the date the business was transferred. If the asset is a partnership share, the first place to look is the agreement by which the person was assumed as a partner, if there is one. Failing this, one might look to

²⁸ IHTA 1984, sections 107 and 118.

²⁹ IHTA 1984, sections 108 and 120. The transferor is deemed to have acquired the property at the date of the death in question, and, if the deceased was his spouse or civil partner, is permitted to add the deceased's period of ownership or occupation to his own.

³⁰ IHTA 1984, sections 109 and 121.

³¹ See *Rosser*, at paragraph 60, for a case in which the taxpayer was fortunate to find himself in a situation where the lack of clear evidence as to period of ownership did not preclude success on this point.

³² Because the date on which a person becomes a shareholder in a company, and thus acquires full ownership of the shares, is the date on which he is entered as a member in the register of members: Companies Act 1985, section 22.

³³ Companies Act 1985, section 356. The company may charge a fee, but this is limited to £2.50 for the first hundred entries in the register of members of which copies are sought: Companies (Inspection and Copying of Registers, Indices and Documents) Regulations 1991 (S.I. 1991 No. 1998). In practice this is rarely charged.

the partnership accounts, showing when the change in profit sharing ratio occurred, or the person's tax returns, showing the date he commenced trading.

33. But if the business was a start-up, there may be some difficulty. This is because the business (or share in it) cannot have been owned before the business actually came into existence. One might look first at the date trading commenced. This could be taken, for example, from accounting records or tax (including VAT) returns. But it is arguable that a business already exists, and therefore that any interest in it is acquired, before trading begins. Where the time from starting trading to the relevant date is shorter than the minimum period of ownership, one might accordingly have to argue that the business came into existence before it started trading, and the date on which it began its life. Relevant facts may include when a bank account was opened (bank records); when expenditure on stock, employees, or premises was first incurred (purchase orders, invoices or receipts; wage records, including PAYE returns; and missives, registered titles, recorded dispositions, and leases); when premises were obtained or moved into; instructions to accountants or solicitors (including letters of engagement); and what is said in the business plan. So records of all these things may be helpful in going to show when there first was a business that the person in question might own.

34. The final category of business property is machinery or plant. Although sales of moveable property are generally less well-documented than sales of land, the type of equipment normally involved in this category will usually come with a written sale contract. This contract is what is required. Where lost, the seller may still have a record of the sale.

35. Two further points may be made in relation to periods of ownership.

36. First, HMRC seems to accept that ‘beneficial ownership’ counts as ‘ownership’ for the purposes of the rules. In relation to land and shares, this opens up the argument that the date of acquisition is, respectively, the date missives are concluded and the date a stock transfer form is executed.³⁴ If the argument is to be made, it is necessary to obtain these prior documents.

37. Second, where replacement property is concerned, it is necessary to know not only dates of acquisition but also dates of disposal. The corresponding evidence is necessary for these too.

VI. Conclusion

38. In conclusion, the right quantity and quality of evidence is crucial to success before a court or tribunal. It is essential to ensure that one has evidence to prove all the facts one needs to, including those facts that will help make a judge believe that the principal facts one wants to prove did in fact occur. But it is also necessary to have the best available evidence of those facts, not only because this will be the most accurate and detailed record of the facts in issue, but also because producing will prevent the judge from getting any suspicion as to why it is not available.

³⁴ Cp. the position in relation to capital gains tax: Taxation of Chargeable Gains Act 1992, section 28.