

# WRIGLEYS

— SOLICITORS —

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Text of an address by Matthew Wrigley

## Conditional Exemption

I thought it would be appropriate in this wonderful place to talk briefly about a heritage topic - conditional exemption from inheritance tax. It is one of several recognised ways for tax planners to deal with the problems of a place like this, but the point I want to make today is that conditional exemption has a much wider application, and can be available in quite modest cases; and a number of factors have come together to make this, in my opinion, a very attractive option for all sorts of people now.

### 1. What is it?

As the name implies, it is not a complete exemption from inheritance tax in the way that agricultural property relief or business property relief are. The exemption is conditional in the sense that it is available so long as property remains unsold, so long as it is managed in a certain way, generally in accordance with an agreed management plan, and so long as reasonable access is provided. In simple terms, it can be available for land of outstanding scenic quality - including the buildings on it - as well as buildings of particular historic or architectural importance. So quite modest buildings - farm houses, cottages, barns and other buildings - can be included, to the extent that they contribute to an outstanding landscape - and that includes a good deal of property in Yorkshire.

### 2. Why is it particularly attractive now?

2.1 Access. It was always the fear, with the right to roam legislation, that however clearly the law defined the land over which that right was given, the assumption in the public eye would be that the right to roam extended anywhere. So it has proved. It follows that an access requirement is much less of an imposition than it was; in fact it may even be attractive to formalise the basis on which it is available, as one can do when agreeing access arrangement for conditionally exempt land; thereafter, to some extent, one is speaking from the moral high ground. I have always held the view that where something is inevitable, one is often much better placed, rather than behaving like Canute, and defying reality, to take pre-emptive action oneself, and to that extent, be able to set the agenda.

Most importantly, where houses and buildings are conditionally exempted, not on their own historic or architectural merit, but because of their contribution to the landscape, there may well be no requirement for access inside the property at all; what is important is the ability to see the property in its setting from the outside. So, in reality, an access requirement may hold no terrors for you.

- 2.2 Limitations of Agricultural Property Relief - Bricks and Mortar. Most of us here will be only too well aware of the consequences of cottages, and farm houses coming out of agriculture. There may be a welcome hike in rent, but there will be appalling problems in terms of a large additional value in one's estate which agricultural property relief no longer shelters from inheritance tax. The beauty of conditional exemption is that it does not affect the owner's entitlement to income; so where, as for most of us here, the preferred policy would be to retain property and maximise the income, rather than see it sold, conditional exemption can be an ideal solution.
- 2.3 Matrimonial Problems. Currently, only 5% of tax payers pay inheritance tax at all, whereas nearly one in two marriages will end in divorce. Many of you will have learned the hard way how much harm divorce can do to a family estate or farm: the damage that can be done to an essentially unitary asset can be fatal. A major attraction of conditional exemption can be that it applies to the inheritance tax payable on putting assets into discretionary trusts, and the subsequent ten year charge, in the same way it does to inheritance tax on death; discretionary trusts are probably the best means of asset protection that there is, and the only reason more property is not held in them is the cost of putting the assets in in the first place. If that can be overcome, the assets can be protected in a way which would not, otherwise, be possible.
- 2.4 Primogeniture. Traditionally, in this country, estate and farms have often devolved on a primogeniture basis, the justification for which has been that putting all the responsibility on one pair of shoulders is the only way to retain family ownership, and that it is reasonable to ask younger siblings, to make sacrifices in support of that goal. But as farming becomes more and more hands-off, many people are finding this an increasingly irrational concept. Again, the structure of a discretionary trust coupled with conditional exemption may be the right answer, to the extent that it protects assets from sales forced by tax or third party claims, but enables income to be distributed between as few or as many members of the family as one likes.
- 2.5 Insurance Policies. The combination of rocketing property values and poor investment performance may have affected many of you, and left you realising that insurance which you thought would take care of most of your inheritance tax problems is no longer going to make a meaningful impression.
- 2.6 The next ten years. Understandably, people in the agricultural industry have not got into the habit of regarding the present as "the good times". But that may well be what they prove to be, as subsidies are progressively withdrawn. What is clear is that funding deficits by sales of property is the start of the downward spiral to disaster. My view is that conditional exemption may give you the best chance possible in a difficult climate to retain assets and maximise income from them.

### **3. Chief Concerns.**

- 3.1 The Illusory Worries. As I have said, the access requirement may no longer be a worry, and may even be an attraction. Similarly, the management plan may impose nothing that the owners would not wish to do themselves, or which an existing framework such as the National Parks may impose anyway.

- 3.2 The Chattels Precedent. The rules about conditional exemption for property are the same as the generally better known rules affecting chattels, where there have been two main problems:
- 3.2.1 Rates of Tax. You will all have heard stories about people who conditionally exempted a Rubens or whatever it was, at 75% on their father's death, when it was worth £100,000, saving £75,000 at the time. They now want to sell the picture for £10m and find that the tax bill is not £75,000 plus interest from father's death, but 75% of the current value, or £7.5m. The points that get overlooked are, first, that £75,000 used to be a lot more money than it is now, and the family almost certainly simply didn't have it at the time. The alternative would have been to sell the picture. The other thing that tends to get forgotten is that the "change" of £2.5m is still worth having. But rates of inheritance tax are currently low, and exemption at current rates could be an attractive option, without this spectre of a historically high rate waiting to hit one later on.
- 3.2.2 Re-Writing the Rules. The other much publicised problem about chattels has been where the Government have retrospectively tried to alter access arrangements made at the time conditional exemption was granted. As it happens, the Revenue have lost their test case on that, and it may be that the Government will have to legislate to get their way; but the point is that in the case of property, the access battle has probably been won already.
- 3.3 Government Manipulation. It has always been a fear that conditional exemption amounted to a kind of creeping nationalisation, and that it would be easy for a Government, for instance, to stop shooting on conditionally exempted land, as a form of political leverage in future. I do not believe that that was realistically threatened in relation to hunting, but the risk is obviously there. Perhaps the most reassuring thing one can say is that, if that happened, one would be in good company: large tracts of moorland have been conditionally exempted, and they have very little value at all, apart from shooting.
- 3.4 DEFRA and the Single Payment. There is a current concern that DEFRA may try to withhold the grant on the basis that it would amount to a double subsidy, but the Capital Taxes Office certainly take the view that they have no justification, and whilst this is obviously something to watch carefully, it looks as if the problem may be containable. You will have seen from Dorothy's latest newsletter that there is to be more CLA guidance on heritage matters, and this will be an obvious source of information.

#### 4. **Summary.**

For all these reasons, I believe that conditional exemption is currently a very attractive option to consider, for those of you with property that might meet the quality standard. There is a means of testing the water for those who wish to take the idea one stage further before finally committing themselves, but my concern is that in the past, Labour Governments have generally been very supportive of the heritage. That is not true of the Governments we have had since 1997, who could be said to have been as hostile to heritage concerns as they have been to agricultural ones. And it is always tempting to do

nothing. But I do think that many people in your position are beginning to see the attractions of the option I have outlined; and, unlike most other options, it is not irreversible. There will of course be a price for doing so, but it is possible to pay the tax and get out of the conditional exemption regime if it no longer suits you.

Now it is worth remembering that as well as the much publicised changes about access in relation to conditional exempt chattels, the Government also took the step, in 1998, of raising the quality threshold. This meant that huge numbers of chattels which had previously qualified for conditional exemption simply ceased to qualify as being of insufficient importance. I do not think it is impossible that something similar might happen in relation to conditional exemption of land and buildings, simply to protect the take from inheritance tax. In short, I believe there is an argument for doing something now.