



ICAEW TAX FACULTY GUIDANCE NOTE

TAXGUIDE 5/11

INHERITANCE TAX – BUSINESS PROPERTY RELIEF AND GROUPS OF COMPANIES

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INHERITANCE TAX – BUSINESS PROPERTY RELIEF AND GROUPS OF COMPANIES

FOREWORD

1. The aim of this TAXGUIDE is to provide some guidance on the practical application of the business property relief (BPR) rules in Chapter I, Part V, Inheritance Tax Act 1984 (IHTA 1984) as they apply to groups of companies.
2. **Part A** of this TAXGUIDE provides a brief overview of BPR; it does not set out the legislative provisions in full.
3. **Part B** contains some examples on the application of the BPR rules to groups of companies which the Inheritance Tax and Trusts Working Group, part of the Tax Faculty's Private Client Committee, put to HMRC. We are grateful to HMRC for allowing us to publish its responses. The treatment of any actual case, however, will depend on its own particular facts.
4. This TAXGUIDE builds on the correspondence between HMRC and the Chartered Institute of Taxation's Succession Taxes Sub-committee (in December 2010/January 2011) which can be found on the CIOT website and is included as Appendix 5 to this TAXGUIDE. That correspondence focused on the qualitative aspects of what constitutes a holding company. The recent correspondence between the Tax Faculty and HMRC looks at structural aspects when considering the availability of BPR in groups of companies.
5. HMRC guidance on BPR can be found in the *Inheritance Tax Manual* at IHTM25131 onwards. Further guidance is provided in the *Shares and Assets Valuation Manual*, which deals with some points to be considered where groups of companies are involved; this can be found at SVM111000.
6. The Tax Faculty would like to thank Andrew Cockman, who chairs the Inheritance Tax and Trusts Working Group, for writing this guidance.
7. Information about the Tax Faculty and ICAEW is given below.
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12. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
13. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a referral scheme and a weekly tax newswire sent to over 18,000 registered users.

PART A – OVERVIEW OF BUSINESS PROPERTY RELIEF

Introduction

14. BPR plays a vital role in an entrepreneurial economy by enabling a business to be handed down through the generations without suffering an inheritance tax (IHT) penalty. The existence of 100% BPR ensures that no IHT is payable when the proprietor of a qualifying family business dies. In the past such family businesses often operated through a single company; however, many have now evolved and grown into groups of companies. This added complexity means that it is more important than ever to understand the way that the BPR rules interact with such arrangements.
15. While the HMRC guidance is helpful there are a number of practical issues which practitioners may face in applying the BPR rules to group structures. The purpose of this guidance is to address some of those issues. It includes agreed HMRC commentary following an exchange of correspondence with the Tax Faculty.

Outline of business property relief

16. The following is an outline of the rules relating to BPR. Note this it does not cover all the aspects in detail. The rules can be found in Chapter I, Part V, IHTA 1984.
17. The level of relief applied under the IHT rules in relation to relevant business property is generous. The general rule is that the property has to be owned by the transferor throughout the two years immediately before the transfer to qualify for relief, although there are special rules for replacement property.

Qualifying property and the rate of relief

18. The types of property that qualify for BPR, and the rate of relief which operates in each case to reduce the value of the relevant business property on a transfer, are as follows:
 - (i) A business or an interest in a business – 100% relief.
 - (ii) Securities of an unquoted company that either by themselves, or together with any other securities or shares owned by the donor, gave the donor control of the company on all major matters affecting the company – 100% relief.
 - (iii) Unquoted shares in a company – 100% relief.
 - (iv) A controlling holding of quoted securities – 50% relief.
 - (v) Land, buildings, machinery or plant which immediately before the gift was used wholly or mainly in a business carried on by a company of which the donor then had control, or by a partnership of which they were then a member – 50% relief.

(vi) Land, buildings, machinery or plant that is settled property in which the donor has a qualifying interest in possession – an absolute right to enjoy its income as it arises – and which is used wholly or mainly for the purposes of a business carried on by them – 50% relief.

19. Shares and securities are treated as being 'quoted' if they are quoted on any recognised stock exchange. Shares traded solely on the Alternative Investment Market are treated as being unquoted.

Qualifying activity

20. Only certain types of businesses qualify for relief. Business activities do not qualify where they consist wholly or mainly in dealing in securities, stocks or shares, land or buildings or in making or holding investments. Similarly, shares or securities held in companies will not be eligible for relief where the companies concerned do not themselves satisfy these tests. This restriction is relaxed in the case of a company that wholly or mainly acts as the holding company of a group where one or more of its subsidiaries undertake qualifying activities. Similarly, market-making companies are treated as undertaking a qualifying activity. Special rules exist which prevent relief being available for non-business related assets, which can mean that the value of non-trading subsidiaries which hold assets not used by another qualifying group company are excluded.

Special rules for lifetime gifts

21. There are special rules that deal with the position where a donor has made a potentially exempt transfer of business assets. This is relevant where the donor fails to survive the making of the gift by seven years or more. In order for the gift to benefit from BPR, the general rule is that the recipient of the gift must still own the property concerned at the date of the donor's death. Where the donee has died, it is necessary for them to have held the property at the date of their death. In either of the above cases there should be no binding contract for sale in place at that time.

22. In addition, the property itself must still qualify as relevant business property, albeit the minimum holding period of two years is ignored for these purposes. This rule is relaxed where the recipient has sold the asset concerned, provided that an equivalent asset is acquired within the following three years. Similarly the rules are relaxed in certain cases where a business is incorporated. A similar set of rules applies where the property was subject to a lifetime chargeable transfer.

HMRC clearance service

23. In January 2009 HMRC extended the IHT clearance service for business owners. This service enables business owners to obtain written confirmation that, in HMRC's opinion, their business will qualify for BPR. Such clearances will be provided where the applicant demonstrates that there is material uncertainty over the application of the law and that the issue is commercially significant to the business. Clearance can be sought pre-transaction, where evidence is supplied that the transaction is genuinely contemplated, or post-transaction.

24. HMRC will also now provide its view of the tax consequences of a transfer of value that involves a change of ownership of a business in the case of succession, where this would (ignoring the application of BPR) result in an immediate IHT charge. In these cases the clearance will only remain valid for six months. HMRC has published guidance on the IHT clearance service for business owners at www.hmrc.gov.uk/cap/clearanceiht.htm

PART B – TECHNICAL POINTS RAISED WITH HMRC

Examples and HMRC responses

25. The examples below were considered in correspondence between HMRC and the Inheritance Tax and Trusts Working Group of the Tax Faculty earlier this year (ie 2011). They cover structural issues relating to the availability of BPR in groups of companies.

EXAMPLE 1 – Intermediate holding companies

26. Over the course of the years there have been a number of published statements and articles that have dealt with these structural aspects. As a result we think it would be helpful to reconfirm the position in the light of the helpful CIOT material. We do not consider that there is any limit on the maximum number of wholly owned holding companies that can be in a group structure for the purposes of eligibility to BPR provided that the Companies Acts requirements are met, as well as the qualitative issues addressed in CIOT material.

27. The key to the structural position is the definition of a holding company in s 1159, Companies Act 2006. For ease, we have replicated para 1 below:

‘A company is a “subsidiary” of another company, its “holding company”, if that other company:

- (a) holds a majority of the voting rights in it, or
- (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
- (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it, or

if it is a subsidiary of a company that is itself a subsidiary of that other company.’

28. At this point please refer to our group structure example in Appendix 1 attached. In this you will see that there are three holding companies and just one trading subsidiary. When we consider the group as a whole, it is our belief that A Ltd is the ultimate holding company and, through the series of holding companies, D Ltd is a subsidiary of A Ltd. We consider this to be possible because of the last part in s 1159(1) above. It seems clear that the term ‘one or more companies’ in s 105(4), IHTA 1984 encompasses all subsidiaries, whether or not the shares are held directly by the ultimate holding company (A Ltd in our example) or by intermediate subsidiaries. It would therefore seem that the number of companies in the structure is irrelevant for determining the availability of BPR purely from a structural point of view.

29. We would welcome HMRC’s confirmation of this interpretation. Even if foreign companies were present in this group structure, we consider that this would not affect our conclusion above.

30. We would welcome HMRC’s confirmation that this is correct and also that this applies whether or not any foreign company has any issued share capital.

HMRC response to Example 1

31. The availability of BPR depends on the nature of the business. The business of a holding company is primarily to hold shares in its direct subsidiaries although, as already noted, the ultimate parent company of a group will generally have other broader activities as well. There is no limit to the number of intermediate holding companies but these cannot be ignored or looked through. These may also have broader activities than simply holding shares in one or more subsidiaries. Each tier in the group structure has to be looked at separately, whether top down or bottom up.

32. In practice, our approach is to look at the group as a whole to determine whether it is mainly investment or non-investment in nature. If the conclusion is that the business of the group as a whole does not consist wholly or mainly of making or holding investments (or other activities within s 105(3), IHTA 1984), we then go on to consider individually all the subsidiaries within the group structure to determine whether any restriction of the relief is necessary in accordance with s 111, IHTA 1984.
33. Foreign companies within the group structure, with or without issued share capital, should not make any difference to the approach.
34. Assuming that in the example at Appendix 1 the three holding companies have no business other than holding shares in their respective subsidiaries (with what that entails), we would first of all agree that the business of the group as a whole does not fall within s 105(3), IHTA 1984. Then, considering in turn the businesses of all the subsidiaries – B Holding Co, C Holding Co and D Trading Co – we would agree that no restriction to the relief is required under s 111, IHTA 1984. The businesses of B Holding Co and C Holding Co fall within s 105(4)(b), IHTA 1984 while the business of D Trading Co does not fall within s 105(3), IHTA 1984 because it has a non-investment business (and is not dealing in shares, etc).
35. Or, looking at it another way; D Trading Co does not fall within s 105(3), IHTA 1984 because it has a non-investment business (and is not dealing in shares, etc). C Holding Co does not fall within s 105(3), IHTA 1984 by virtue of s 105(4)(b), IHTA 1984 because its business consists wholly or mainly of being a holding company of D Trading Co, which does not fall within s 105(3), IHTA 1984. B Holding Co does not fall within s 105(3), IHTA 1984 by virtue of s 105(4)(b), IHTA 1984 because its business consists wholly or mainly of being a holding company of C Holding Co, which does not fall within s 105(3), IHTA 1984. A Ltd does not fall within s 105(3), IHTA 1984 by virtue of s 105(4)(b), IHTA 1984 because its business consists wholly or mainly of being a holding company of B Holding Co, which does not fall within s 105(3), IHTA 1984. The shares in A Ltd would therefore qualify for BPR.

EXAMPLE 2 – Indirect subsidiaries

36. In Example 1 there was a direct 100% ownership structure and therefore it would be right that the ultimate holding company would be in a position where it holds the majority of the voting rights in the trading companies. However, where we have two companies (A Ltd and UK Trading Co 1) that each own different percentages of the voting rights in UK Trading Co 2 (see Appendix 2) the position is not so straightforward for A Ltd.
37. We believe that the answer lies within s 1159(1)(c), Companies Act 2006. It is our interpretation that relief should still be available as long as A Ltd has an agreement with UK Trading Co 1 that enables A Ltd to hold the majority of voting rights of UK Trading Co 2.
38. We would welcome HMRC's views on our interpretation.

HMRC response to Example 2

39. It is more difficult to generalise in this situation as each case depends on its own facts but the approach is the same – we look at each company and determine what the main business of that company is and whether it falls within s 105(3), IHTA 1984 and/or s 105(4)(b), IHTA 1984. In your Appendix 2 example, the business of A Ltd consists of being a holding company of two non-investment subsidiaries so it would not fall within s 105(3), IHTA 1984.

EXAMPLE 3 – Dual trading and holding companies

40. We understand that a company's business which consists wholly or mainly of the activities of a holding company will qualify for BPR (s 105(4)(b), IHTA 1984) provided the subsidiaries are themselves trading. Where the business of a holding company consists of both the company's own trading (or investment) activities and holding company activities, our interpretation is that the shares in the holding company still qualify for BPR, provided that the business consists wholly or mainly of the company's own trading activity or of holding trading subsidiaries. See Appendix 3(1) for an example of this potential structure. You will see that the split of the sub-holding company's assets are 45% for its own trade, 40% for trading subsidiary shareholdings and 15% for its own investment property business. It seems clear that the shares should qualify. However, it could be argued that it is neither 'wholly or mainly a holding company' nor 'wholly or mainly a trading company'.
41. We need to consider 'the business' in the context of duality of purpose and believe that this should be looked at purposively; if the company were viewed on its own business alone then it would qualify and if it were viewed purely as a holding company of trading subsidiaries then it would qualify. We would suggest that full relief should be available where the company's business is wholly or mainly attributable to either the trade of the holding company itself or of holding trading subsidiaries or a combination of both. We would welcome HMRC's view on our interpretation as regards the group structure set out at Appendix 3(1).
42. We should also be grateful for your comments in relation to the group structure set out at Appendix 3(2). You will see that we have slightly changed the facts. The value of the investments held by the sub-holding company is 40%, rather than 15%, of the total value of the assets held by the sub-holding company. We assume that you would look at the overall position of the sub-holding company, which would mean that in the revised example the overall activities would not fall within s 105(3), IHTA 1984 – so BPR would be available.

HMRC response to Example 3

43. We would look at where the preponderance of activities lay and, if this does not consist of activities within s 105(3), IHTA 1984, BPR would be available.
44. We agree that BPR would be available in the Appendix 3(1) example.
45. In the case of your Appendix 3(2) example, we confirm that we look at the whole sub-group to determine if there is a mainly non-investment business, which means we agree that BPR would apply.

EXAMPLE 4 – Intragroup funding

46. This section considers intragroup loans in combination with some of the above scenarios
47. In larger, privately-owned groups it is not uncommon to see a mixture of all of the above potential scenarios developing over time. This may, for example, be attributable to group reorganisations over the years, or be the result of inheriting historic positions following acquisitions.
48. In the example at Appendix 4 loans are being made at different levels of the group and have each arisen in different circumstances. Loan A arose to finance the acquisition of UK Holding Co 2 from a third party (which at the time owned Overseas Trading Company 1 and UK Trading Co 3). Loan B arose to finance UK Holding Co 3 in order that it can acquire Overseas Holding Company 1 from another group company (which at the time owned Overseas Trading Company 2). Loan C has arisen because UK Trading Company 2 has surplus cash and UK Trading Company 3 needs financing to purchase some plant for use in its trade.

49. We could, of course, give many more examples as the use of intragroup loans is commonplace in large corporate groups. The point is that the process of companies funding group subsidiaries to make acquisitions (either of business units/divisions or of companies or sub-groups that are wholly or mainly trading businesses/companies or sub-groups) is often achieved through a mixture of debt and equity. In such circumstances we do not regard the provision of loans, or other finance, by group companies as being made for investment purposes, provided that in each case the companies making the loans are either themselves mainly trading companies, or holding companies that mainly hold shares in trading subsidiaries.

50. We would welcome HMRC's view on this.

HMRC response to Example 4

51. There is little that we can add to the previous response given to CIOT (see Appendix 5) as each case depends on its own facts. It will depend on where funds are held within the group and the purpose of any loans. Intragroup loans may be made as an alternative to third party finance if there are surplus funds, or may be made by a group finance company that itself deals with external group borrowings (or indeed a variety of other combinations). A loan made to support non-investment business activity would not itself be regarded as an investment. A loan made to enable further acquisitions would have to be judged on the specific facts of the case including the nature of the acquisition and the significance of the loan in the overall business of the lending company and the group as a whole. We would look critically at any loans that appeared to have a non-commercial purpose but these would still be viewed in the context of the group as a whole.

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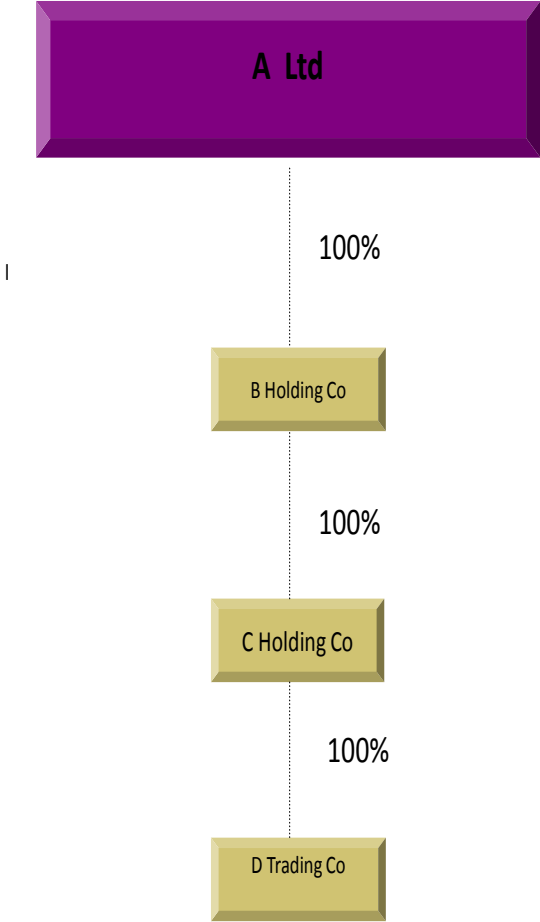
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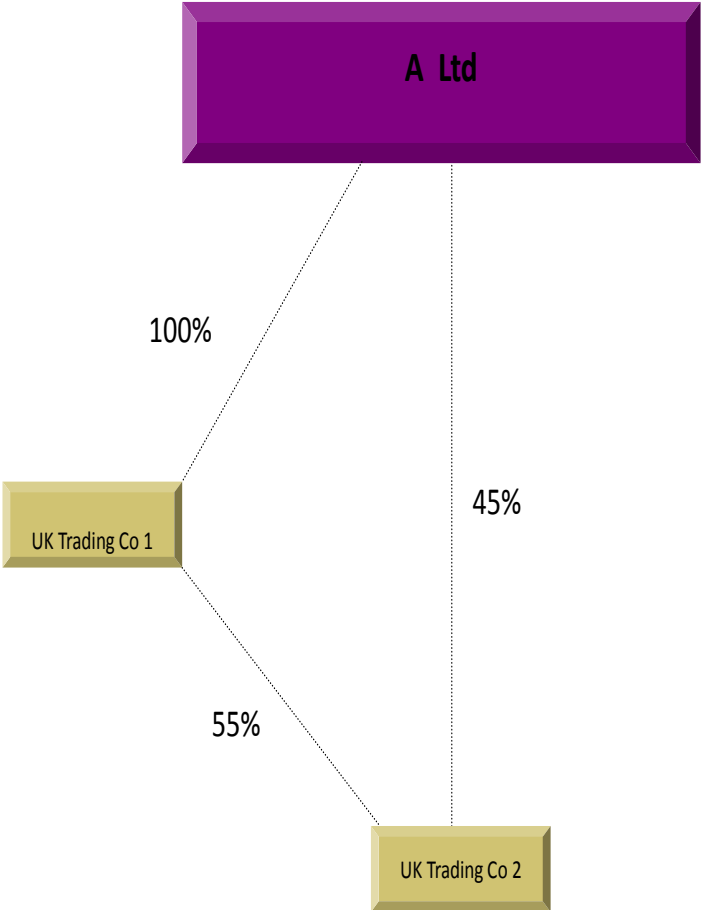
APPENDIX 1

EXAMPLE 1 – INTERMEDIATE HOLDING COMPANIES



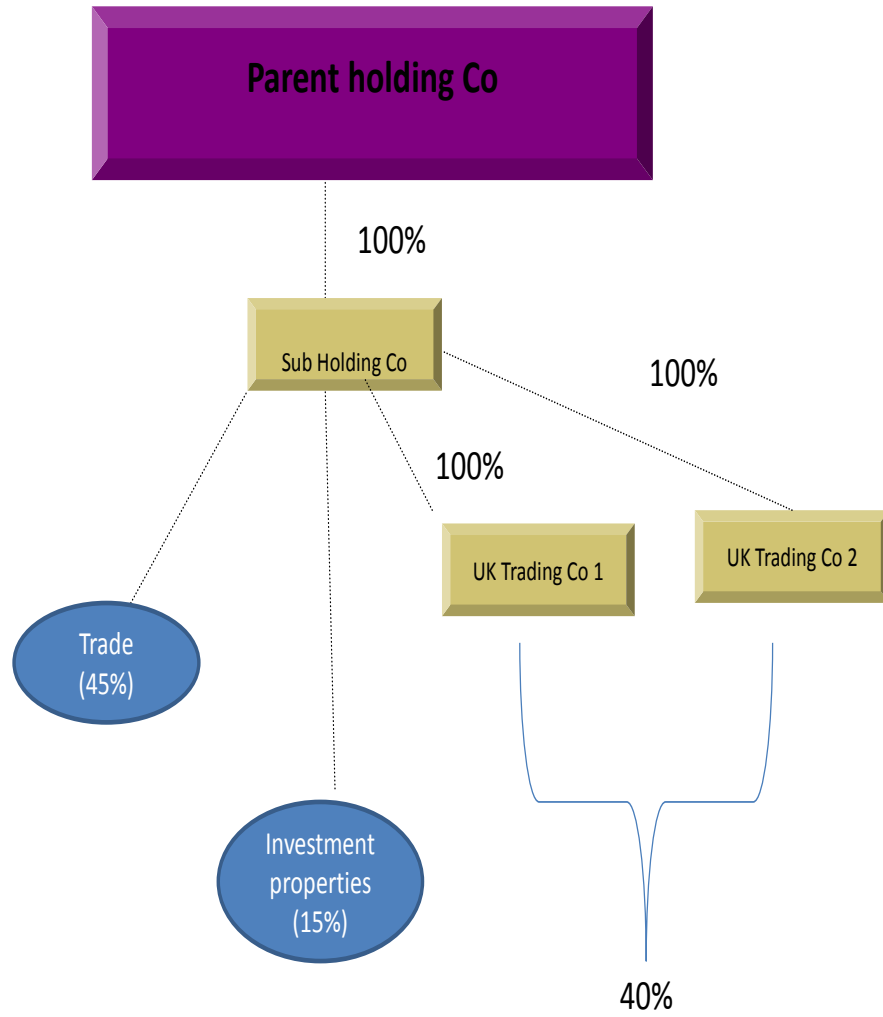
APPENDIX 2

EXAMPLE 2 – INDIRECT SUBSIDIARY



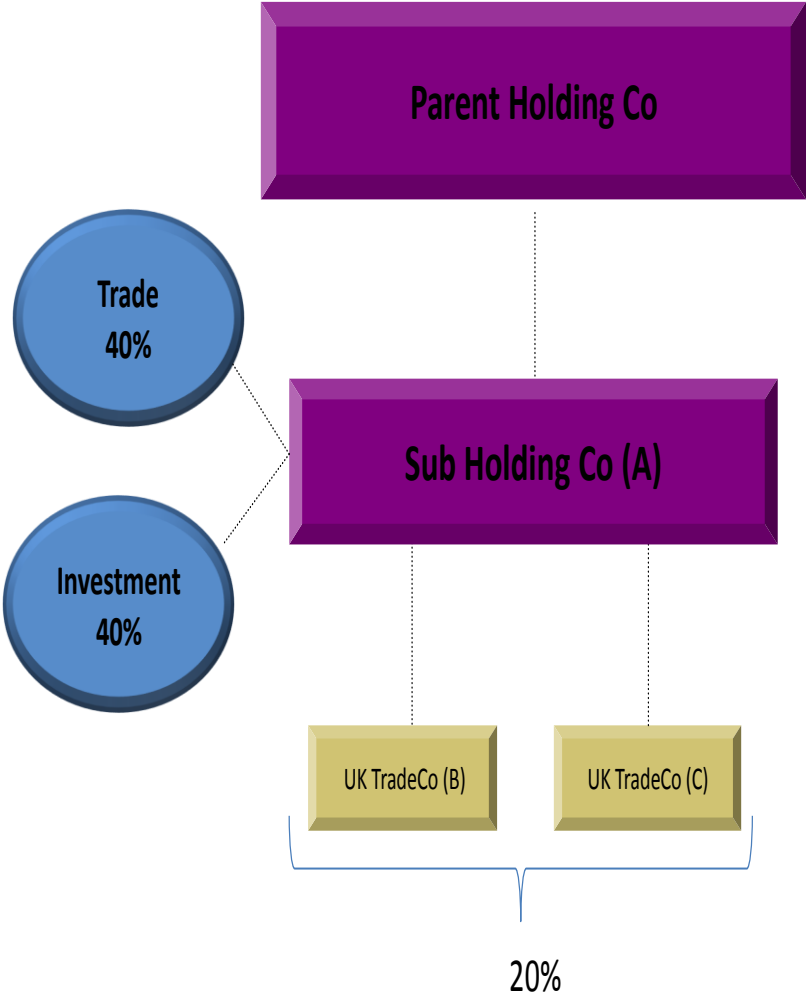
APPENDIX 3(1)

EXAMPLE 3 – DUAL TRADING AND HOLDING COMPANY (1)



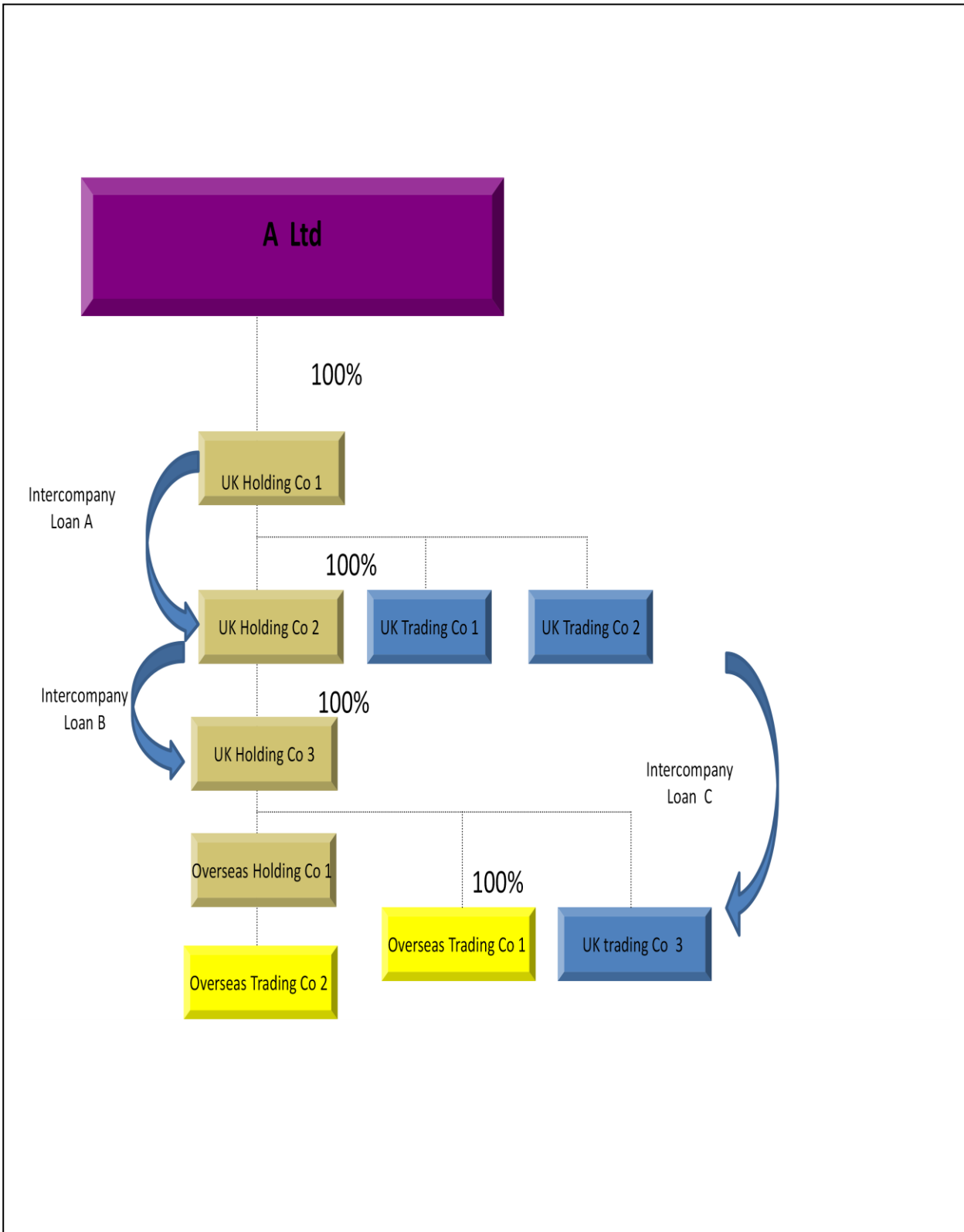
APPENDIX 3(2)

EXAMPLE 3 – DUAL TRADING AND HOLDING COMPANY (2)



APPENDIX 4

EXAMPLE 4 – INTRAGROUP FUNDING



APPENDIX 5

PREVIOUS CORRESPONDENCE BETWEEN HMRC AND CIOT

As noted in the Foreword, this TAXGUIDE builds on the correspondence between HMRC and the Chartered Institute of Taxation's Succession Taxes Sub-committee (in December 2010/January 2011). That correspondence focused on the qualitative aspects of what constitutes a holding company.

The correspondence has been published on the CIOT website at:

[www.tax.org.uk/Resources/CIOT/Documents/2011/04/Holding%20company%20for%20BPR%20s105\(4\)%20purposes%20HMRC%20Correspondence.pdf](http://www.tax.org.uk/Resources/CIOT/Documents/2011/04/Holding%20company%20for%20BPR%20s105(4)%20purposes%20HMRC%20Correspondence.pdf)

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AVAILABILITY OF IHT BUSINESS PROPERTY RELIEF FOR GROUP STRUCTURES

1 INTRODUCTION

1.1 HMRC have agreed that correspondence with the Chartered Institute of Taxation's Succession Taxes Sub-committee may be published. Sections 2 and 3 below set out the query made on 15 December 2010 and HMRC's response of 10 January 2011 is at Section 4.

2 THE ISSUE

2.1 We have received a number of queries about the availability of business property relief (**BPR**) for shareholdings in the holding company of a group of companies.

2.2 While we think that the answer to the question should clearly be that relief is available, we thought it sensible to ask for HMRC's views so that the matter can be put beyond doubt.

2.3 The exact facts of each case obviously differ, but a typical scenario would involve a holding company whose main activity is ostensibly holding shares in trading subsidiaries. [Note: we use 'trading' as a shorthand for the test in s.105(3), namely that the company in question's business does NOT consist wholly or mainly of dealing in securities, stocks or shares, land or buildings or making or holding investments. We appreciate that, in practice, there may be some distinctions between the two.]

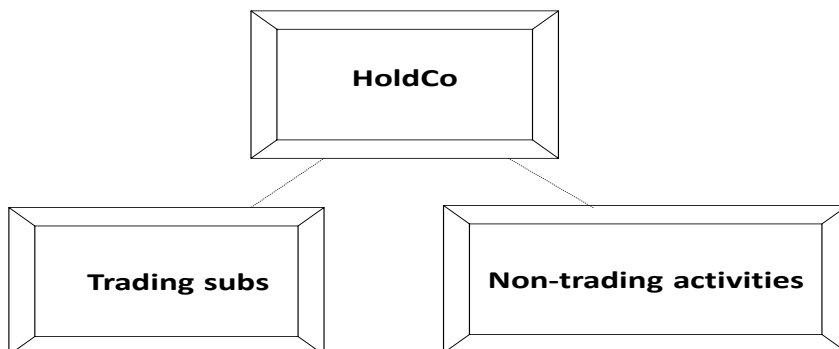
The holding company's business may also involve various other non-trading [this term is used in the same sense as in the note above] activities but where – subject to the following – the holding of shares in trading subsidiaries clearly predominates.

2.4 However, in addition to its shareholding in the trading subsidiaries, the holding company may also have made intra-group loans to the trading subsidiaries.

2.5 If this loan is – under s 105(4) IHTA - treated as part of the holding company's 'business of being a holding company of [s 105(3) qualifying] companies' then the trading side of the business will still predominate. However, if the loan is treated as being on the 'wrong side of the line' then it may tip the balance so that non-trading activities predominate, thus denying BPR entirely to the shareholdings in the holding company.

2.6 Diagrammatically this looks as follows:

Trading subs owe £Xm to HoldCo



3 LEGISLATIVE BACKGROUND

3.1 BPR is available where whole or part of the value transferred by a transfer of value is attributable to the value of the relevant business property. The relief operates by treating the whole or part of the value transferred as reduced by 100% (s.104 IHTA 1984).

3.2 Section 105(3) IHTA 1984 sets out a test whereby BPR is not available, and this test is framed in the negative. All shareholdings potentially qualify for BPR unless the business of the company consists wholly or mainly of certain excluded activities.

3.3 Section 105(3) IHTA 1984 would preclude most group structures, however, there is an exception at s 105(4) for holding companies.

3.4 This exception does not focus on the group as a whole, but on the business of each separate company in that group. The nature of each company's business is looked at, starting with the business carried on by the holding company.

Is there a business in this case?

3.5 In order to qualify for BPR it is necessary to establish that there is indeed a 'business' at all. In this example, it is assumed that HoldCo is carrying on a business.

3.6 It is also assumed in this case that there is a single business and that the business is carried on for gain (s 103(3) IHTA 1984).

What is the business of HoldCo?

3.7 The crucial test as to whether BPR applies is whether the business of HoldCo consists predominantly of being a holding company of one or more companies (s 105(4) IHTA 1984).

3.8 There is then a definition of 'holding company' which cross-refers to s.1159 and Schedule 6 Companies Act 2006. That definition refers simply to a company being a subsidiary of another company (its '**holding company**'), if the holding company:

- (a) Holds a majority of votes in the subsidiary; or

(b) Is a member of the subsidiary and has the right to appoint and remove the majority of its board of directors; or

(c) Is a member of it and controls.....a majority of the voting rights in it.

3.9 Schedule 6 contains some further amplification of the above tests, but does not alter the substance of s.1159.

3.10 What is unclear is whether - when this definition is transposed into s 105(4) IHTA - it provides an exhaustive definition of 'a business consisting....of being a holding company'. Or, putting it another way, does the incorporation of s.1159 define 'holding company' or 'the business of being a holding company'? And, if the former, of what does the business of being a holding company consist?

3.11 The distinction is important because if the incorporation of s.1159 provides an exhaustive definition of the business of being a holding company then other activities (such as loans to subsidiaries) presumably do not form part of that business and therefore fall the wrong side of the s.105(4) line. Conversely, if the business of being a holding company is a wider concept then providing loan-finance to subsidiaries would, we suggest, be treated as an ordinary activity which many holding companies would undertake.

3.12 We think that it is generally accepted that the latter view is the right one, but we think that HMRC's confirmation of this would be sensible.

3.13 We would accept that the wider definition still lacks clarity as to what the business of being a holding company consists of. This is presumably a question of fact to be answered in each case. We would suggest that a tentative description of the business of a holding company could include one or more of the following activities:

(a) Holding the shares in subsidiaries;

(b) Co-ordinating the activities of those subsidiaries by means of voting control and the ability to control the subsidiary boards;

(c) Provision of loan and other finance to those subsidiaries;

(d) Providing strategic direction and oversight of the activities of subsidiaries and ensuring that the subsidiaries work together to achieve a common aim;

(e) Monitoring the financial performance of subsidiaries; providing a 'treasury' function and co-ordinating guarantees and cross-group collateral;

(f) Providing a structure to allow ring-fencing of the activities of subsidiaries; nurturing new higher-risk activities within the limited liability offered by subsidiaries; re-organising the businesses of subsidiaries as they change and grow; and

(g) Managing relations with shareholders on behalf of all subsidiaries.

3.14 We would, however, welcome HMRC's views on this question to put the matter beyond doubt.

4 HMRC'S REPLY OF 10 JANUARY 2011

4.1 Section 1159 Companies Act 2006 defines the structural relationship between a holding company and a subsidiary in terms of control and voting rights. Reading this into IHTA 1984 tells us whether or not a company is (structurally) a holding company but does not provide any definition of what the business of that holding company may be. HMRC look at the activities

undertaken by any particular company from first principles to determine what the main business of that company is and whether it falls within the provisions of section 105(4)(b) IHTA 1984. We apply the factors as set out in the Farmer case and look at the business 'in the round'.

4.2 All cases depend on their own facts, but we agree that the following activities are indicative of the business of a holding company:

- (a) Holding the shares in subsidiaries;
- (b) Co-ordinating the activities of those subsidiaries by means of voting control and the ability to control the subsidiary boards;
- (c) Provision of loan and other finance to those subsidiaries;
- (d) Providing strategic direction and oversight of the activities of subsidiaries and ensuring that the subsidiaries work together to achieve a common aim;
- (e) Monitoring the financial performance of subsidiaries; providing a 'treasury' function and co-ordinating guarantees and cross-group collateral;
- (f) Providing a structure to allow ring-fencing of the activities of subsidiaries; nurturing new higher-risk activities within the limited liability offered by subsidiaries; re-organising the businesses of subsidiaries as they change and grow; and
- (g) Managing relations with shareholders on behalf of all subsidiaries.

4.3 If these or similar activities predominate and the group subsidiaries are themselves non-investment companies, then business property relief would normally be available for the shares in the holding company.

4.4 In relation to intra group loans, these are regarded as non-investment where the loans are used by the subsidiaries for the purposes of their non-investment businesses and the amounts are reasonable in the context of the group business as a whole.

4.5 We will take account of your query and this response when we next come to update our published guidance on BPR. In the meantime, I hope your members find this message helpful.